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IN THE  
**Supreme Court of the United States**  
OCTOBER TERM, 1977

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No. 77-753

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INTERNATIONAL BROTHERHOOD OF TEAMSTERS,  
CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA,  
*Petitioner,*

v.

JOHN DANIEL,  
*Respondent.*

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On Writ of Certiorari to the United States Court of Appeals  
for the Seventh Circuit

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**BRIEF FOR  
INTERNATIONAL BROTHERHOOD OF TEAMSTERS**

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INTERNATIONAL BROTHERHOOD OF TEAMSTERS,  
CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA,  
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JOHN DANIEL,  
*Respondent.*

On Writ of Certiorari to the United States Court of Appeals  
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BRIEF FOR  
INTERNATIONAL BROTHERHOOD OF TEAMSTERS

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Seventh Circuit is reported at 561 F.2d 1223. It is reproduced at A. 209-262.<sup>1</sup> The opinion of the United States District Court for the Northern District of Illinois, Eastern Division, is officially reported at 410 F.Supp. 541, and is reproduced at A. 106-134.

JURISDICTION

The judgment of the United States Court of Appeals for the Seventh Circuit was entered on August 20, 1977. Petition for a writ of certiorari was granted on February 21, 1978 (A. 263). This Court has jurisdiction under 28 U.S.C. § 1254(1).

<sup>1</sup> "A." refers to the Appendix filed in this Court. The Securities and Exchange Commission will be referred to as "SEC" or the "Commission;" its brief in the court below will be referred to as "SEC Br." Other references to "Br." preceded by a name will similarly refer to a brief filed in the court below or in this Court by that party or *amicus*.

## QUESTIONS PRESENTED

Does an employee's coverage under an employer funded pension plan, as a compulsory incident of his employment, involve the "sale" of a "security" to the employee and hence a transaction subject to the federal securities laws? If so, can a cause of action be posited on each of the several antifraud provisions of those laws by one who alleges that there were material misrepresentations and failures to disclose in connection with such a "sale?"

## STATUTES AND RULE INVOLVED

This case involves §§ 2(1), 2(3), 3(a)(2), and 17(a) of the Securities Act of 1933, 48 Stat. 74 as amended (15 U.S.C. §§ 77a *et seq.*); §§ 3(a)(10) and 10(b) of the Securities Exchange Act of 1934, 48 Stat. 881 as amended (15 U.S.C. §§ 78a *et seq.*) and SEC Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5; §§ 9(a) and 302(c)(5) of the National Labor Relations Act of 1935, as amended by the Labor Management Relations Act of 1947, etc., 49 Stat. 449, 61 Stat. 136, 73 Stat. 519 (29 U.S.C. §§ 141 *et seq.*) and §§ 102 and 3004 of the Employment Retirement Income Security Act of 1974, 88 Stat. 832 (29 U.S.C. §§ 1001 *et seq.*). They are reproduced in an Appendix *infra*.

## STATEMENT OF THE CASE

### A. Plaintiff's Complaint and the Proceedings Below.

The complaint in this case was filed on October 3, 1974 as a class action brought on behalf of all members of the International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America ("IBT") (A. 1, 24).<sup>2</sup> Plaintiff alleges that he has been a member of

<sup>2</sup> The claimed plaintiff class was subsequently refined by plaintiff's motion for class action certification to include all members of all local affiliates of the IBT who have an interest in any Teamster pension fund "which requires for the payment of a full retirement benefit a

Local 705 of the IBT since 1951; that payments have been made on his behalf into the Local 705 pension fund for a period of 22½ years (including what the complaint denominates as "past service contributions"); that the vesting provisions of the Local 705 pension plan require 20 consecutive years of uninterrupted service; and that by reason of an involuntary break in service of four or seven months in 1960-61 he has been denied all benefits under the Local 705 pension plan (A. 31). The complaint further alleges that beginning at least as early as 1955, Local 705, the IBT, all the locals of IBT, their officers and the individual Trustees of all Teamster pension funds have knowingly misrepresented material facts and omitted to state other material facts relating to the value of a member's participating interest in a pension fund including, *inter alia*, misstatements and omissions with respect to vesting, length of service and continuity requirements, the actuarial basis on which a fund has been created, the actuarial likelihood that a member will receive a pension benefit, and the diversion of funds from their lawful purpose to the benefit of defendants or others (A. 33). The complaint does not specify in what way the omnibus allegation with respect to diversion of funds is applicable to the Local 705 fund.

The complaint consists of six counts. Only the first two, based on Section 10(b) of the Securities Exchange Act of 1934 and Commission Rule 10b-5 and Section 17(a) of the Securities Act of 1933 respectively, are directly before this Court (A. 25-38). Count III, based essentially on the same factual allegations as Counts I and II, alleges that these facts constitute a violation of defendants' statutory duty of fair representation under

total period of service in excess of ten years" (A. 98). There are 230 such pension funds (A. 195). The district court has certified a class consisting of all persons who are now or ever were members of Local 705 who acquired an interest in the Local 705 pension fund through contributions made on their behalf. (Opinion and Order, June 29, 1977)

Section 9(a) of the National Labor Relations Act (A. 38-42). Count IV, again based on the same factual allegations as the federal securities counts, asserts that these facts constitute common law fraud and deceit (A. 42-43). Count V repeats the former allegations, alleges that the defendants owe plaintiff and the members of his class a fiduciary duty to establish and operate fair and reasonable pension plans for the sole and exclusive benefit of employees and that duty has been breached (A. 43-47). Finally, Count VI alleges violation of Section 302 (c) (5) of the Taft-Hartley Act, 29 U.S.C. § 186(c) (5), through the establishment and use of arbitrary and unreasonable length of service and continuity requirements and by reason of fund diversion. (A. 89-93).

The identical relief (except of a declaratory nature) is sought with respect to all counts, to wit: reformation of all pension fund agreements to delete the allegedly arbitrary length of service and continuity requirements, money judgment for plaintiff and all members of the class in an amount equal to all pension benefits claimed to have been unlawfully denied and a money judgment for all funds which are said to have been diverted from their lawful purposes.

The court below treated an affidavit filed by the plaintiff some months after the filing of the complaint as part of the pleadings for purposes of its review of the district court's order denying the motion to dismiss (A. 213). In his affidavit plaintiff swears that from 1955 on he understood that he would be eligible to receive a retirement benefit upon completing 20 years of employment with Local 705 covered employers; that this was a "material factor" in his continuing in employment with such employers; and that had he known the manner in which the eligibility provisions of the Pension Plan would be interpreted, he would have sought employment (and if necessary retraining for new employment) elsewhere. He further states that although he from time to

time received various communications pertaining to the Local 705 pension plan, it remained his understanding and belief that he would receive a pension if he completed 20 years of service, and that the first time he became aware that his break in service in 1960-1961 made him ineligible to receive a pension was after his retirement when he filed his pension application. Finally he states that his understanding was the common understanding of Local 705 members. (The affidavit is reproduced as an appendix to the Brief of Respondent John Daniel in Opposition to The Petitions for Writs of Certiorari).

The complaint purported to satisfy the threshold requirements of the antifraud provisions—that there be a "sale" of a "security"—on the unprecedented theory that plaintiff Daniel and other employees in the group covered by the plan "have purchased and acquired an interest in [the plan] \* \* \* by agreeing to provide their labor services to employers who have labor contracts" requiring such contributions (A. 34). Defendants moved to dismiss the securities counts<sup>3</sup> on the ground that there is no "sale" of a "security" in connection with such a "compulsory noncontributory" union pension plan, coverage under which is a mandatory incident of employment and which is wholly funded by employer contributions. The District Court accepted plaintiff's theory with some modification and denied the motions to dismiss. The District Court determined (1) that <sup>interests in</sup> pension plans are "securities", (A. 112-124) and (2) that there is a "sale" of <sup>an interest in</sup> a collectively bargained pension plan when union members vote to ratify an agreement negotiated by their union, if that agreement provides for employer contributions to a pension fund (A. 125-128). The Court was undeterred by its

<sup>3</sup> Defendant Local 705 also moved to dismiss all of the other counts of the complaint on a different basis including statutes of limitations, lack of subject matter jurisdiction and absence of indispensable parties (A. 49-52). The District Court denied all aspects on the motion (A. 107-111, 129-134).

recognition that "the SEC had taken the position that with respect to those employee pension plans characterized as 'involuntary' or 'noncontributory', there is no sale within the meaning of the Securities Acts." (A. 126)

The defendants sought and were granted leave to appeal under 28 U.S.C. § 1292(b) from so much of the order as denied the motions to dismiss the securities law counts. In the Court of Appeals, the Department of Labor filed a brief *amicus* in support of the defendants' position; the SEC filed a brief *amicus* in support of the appellee.

The Court of Appeals affirmed. In an opinion by Judge Cummings, the court agreed with the District Court that "Plaintiff's Interest in the Pension Fund is a Security" (A. 219). It characterized the union member as an "investor" (A. 222-225), and concluded that the *Howey*<sup>4</sup> standards for an "investment contract" were satisfied (A. 225-230). The court concluded also that "plaintiff's security was acquired in a 'sale'" (A. 242-247). But unlike the District Court, it determined that there is the sale of an interest in a pension plan whenever an employee accepts or remains in employment covered by a pension plan.<sup>5</sup> The court determined there was a sale not only for purposes of § 10(b) of the 1934 Act, but also under § 17(a) of the 1933 Act which it held, in accordance with prior Seventh Circuit decisions, creates an implied private cause of action. (A. 247-250)

The Court of Appeals incorrectly stated that "defendants and *amici* who support their position urge that the Employment Retirement Income Security Act of 1974

<sup>4</sup> See *SEC v. W. J. Howey Co.*, 328 U.S. 293, 301, reaffirmed in *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852.

<sup>5</sup> The court did not expressly approve or disapprove the district court's theory that ratification of a collective bargaining agreement which provides for employer contributions to a pension plan constitutes a sale. Compare A. 229, 242-247 with A. 254-255.

(ERISA) has repealed the anti-fraud provisions of the 1933 and 1934 Acts insofar as they apply to union pension funds," and went on to conclude that ERISA did not effect such a repeal (A. 250-254). Actually, the argument was that Congress had enacted ERISA with the understanding that the securities laws were inapplicable to the relationship between plans such as this and their participants and that this Congressional action should be respected in construing the securities laws, particularly since securities laws coverage would conflict with several policy decisions Congress had made in enacting ERISA. Yet, the court made a policy judgment that the anti-fraud provisions of the securities laws would provide a desirable addition to the ERISA requirements (A. 254-255). To the extent it discussed the demonstration by defendants and *amici* on their side that affirmation of the District Court's decision would create enormous potential liabilities for all pension funds, the court's opinion characterized those arguments as a "parade of horrors" and dismissed them out of hand as the product of the "zeal [of] advocates." (A. 258-259)

Judge Tone filed a separate concurring opinion in which he professed "certain doubts" about the opinion of the court, calling this "a close and difficult case." He said that some of his doubts flowed from the "ordinary meaning" of the words employed in the federal securities laws and from "Congress' basic purpose in adopting" those laws. He believed, however, that "considering the breadth of the definitions of 'investment contract' and 'sale' in the statutes themselves and the interpretation of those terms in cases we must still regard as authoritative, \* \* \* the balance tips in favor of the plaintiff's position." (A. 260). Judge Tone also indicated some discomfort with "attempts to stretch the securities laws beyond their traditional scope" and acknowledged this Court's recent decisions indicating "pronounced disfavor" with such attempts (*Id.*). He expressed a quite different view

of the SEC's historical and present position regarding the securities laws' applicability to noncontributory pension plans than that stated by Judge Cummings (Compare A. 260-261 with A. 233-235), protested that the "Commission has not been as candid as we might have hoped in acknowledging and explaining its change in position" (A. 260), and agreed with the defendants that "[m]embers of Congress considering legislative proposals after the adoption of the securities acts who relied on the SEC's interpretation of those acts must have understood that they did not apply to transactions of the kind before [the court]" (A. 261). He concluded, however, that Congress should be deemed to have left the matter in a posture where the applicability of the securities laws to noncontributory pension plans would be "determined by the Supreme Court." (A. 262)

#### **B. The Characteristics of Pension Funds and Plans.**

The details of the Local 705 plan are set forth in the Brief of Local 705. However, because we believe that an understanding of the characteristics of pension plans is essential to an understanding of the issues in this case, we briefly describe those characteristics and their major variations.

Prior to the adoption of the Employee Retirement Income Security Act of 1974 ("ERISA") pension plan sponsors (employers or joint boards of trustees in the case of many collectively bargained plans), had almost unlimited flexibility with respect to the design of retirement plans. Plans differed with respect to the scope of coverage, the nature and amount of benefits to be provided, funding methods and formulas, eligibility requirements and vesting provisions, and the inclusion of a wide variety of optional features. Since the effective date of ERISA many more substantive requirements must now be met, but the freedom of the plan sponsor to fashion the terms of the plan still remains very broad.

As to the scope of coverage, pension plans fall into two general categories: single employer and multi-employer plans. A multi-employer plan covers the employees of two or more financially unrelated employers. Under this type of plan, contributions are payable into one common fund and benefits are payable to eligible claimants from that fund. Multi-employer plans are usually the product of collective bargaining<sup>6</sup> and are most prevalent in industries where employees' work and union affiliation remain stable while their specific employers may change.<sup>7</sup> See, e.g. McGill, *Fundamentals of Private Pensions*, Pension Research Council, Wharton School, University of Pennsylvania (Homewood, Ill., Richard D. Irwin, Inc., 3rd ed. 1975) at 78-79.

Pension plans are categorized as contributory or non-contributory. Under a contributory plan both the employee and the employer make contributions to the plan. E.g., *Los Angeles Dept. of Water & Power v. Manhart*, — U.S. —, No. 76-1810 (decided April 25, 1978). A contributory plan will contain provisions for the return, at a minimum, of the employee's contributions plus interest if his employment is terminated before the anticipated retirement age. In a non-contributory plan the full cost of the plan is borne by the employer. Melone, *Collectively Bargained Multi-Employer Pension Plans*, Pension Research Council, Wharton School of Finance and Commerce (Homewood, Ill., Richard D. Irwin, Inc., 1963) at 35-36. E.g., *Alabama Power Co. v. Davis*, 431 U.S. 581; *Fleck v. Spannaus*, No. 77-747, Brief for Appellant Structural Steel Co. at 10a.

Where an employee has the option not to participate in a pension plan, such a plan is denominated "voluntary."

<sup>6</sup> While multiemployer plans are jointly administered by the employers and the union, single employer plans may be either jointly administered or administered solely by the employer.

<sup>7</sup> Many single employer plans are also the product of collective bargaining.

Those plans, such as the Local 705 plan, which provide for automatic participation as a mandatory incident of employment are "involuntary" or "compulsory" plans, *e.g.*, *Malone v. White Motor Corp.*, — U.S. —, No. 76-1184 (decided April 3, 1978); *Alabama Power Co. v. Davis*, 431 U.S. at 590. Contributory plans can be entirely voluntary or compulsory both with respect to participation and employee contributions. Alternatively, they can be compulsory with respect to participation based upon employer contributions and voluntary with respect to employee contributions.

There are two major types of benefit arrangements, defined benefit plans and defined contribution plans. Under a defined benefit plan "the benefits to be received by employees are fixed and the employer's contribution is adjusted to whatever level is necessary to provide those benefits. The other basic type of pension is a 'defined contribution' plan, under which the employer's contribution is fixed and the employee receives whatever level of benefits the amount contributed on his behalf will provide." *Alabama Power Co. v. Davis*, 431 U.S. at 593, n.18.

Under a defined contribution plan, individual accounts are kept for each eligible employee during the period while he is still working, and an amount is credited annually to each of those individual accounts. The funds are invested and the earnings or the losses serve to increase or decrease the amount in the account. Since the amount in each individual employee's account is used to provide benefits for that employee upon retirement, the investment experience affects quite significantly the amount of the benefits that will be received.

Under a defined benefit plan, such as the Local 705 Pension Plan, the level of pension benefits is fixed and eligibility requirements are based on length and continuity of service and age. Compare *Johnson v. Botica*, 537 F.2d 930, 932-933, 936-937 (C.A. 7). The rate of

pension payments that can be given to retirees is determined by the following actuarial factors, as enumerated by a leading text, Melone, *Collectively Bargained Multi-Employer Pension Plans*, Pension Research Council, Wharton School of Finance and Commerce (Homewood, Ill., Richard D. Irwin, Inc. 1963): (1) "[t]he mortality experience of both active employees and pensioners"; (2) "turnover" by "[e]mployees who terminate their coverage under the plan for reasons other than death or retirement"; (3) "investment income earned on the accumulated assets of [the] \* \* \* fund"; (4) "the expense of administering a pension program"; (5) "[t]he age at which employees retire"; (6) employers' "future contribution levels", which are "one of the most important factors . . ." *Id.* at 77-85. Melone further notes the actuarial impact of the "initial accrued liability" (or "past service liability") for employees who—like Mr. Daniel and others grandfathered into the Local 705 Plan—are given pension credit ("past service credit") for years prior to the commencement of contributions. *Id.* at 88-89.\*

Typically pension plans provide that an employee shall have no interest or right in the fund itself until vesting has occurred, usually as a consequence of the period during which the employee has been a participant in the

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\* See also, *e.g.*, *Alabama Power Co. v. Davis*, 431 U.S. 581, 590. Past service is normally recognized in a newly-created plan but is commonly funded on a deferred basis, *e.g.*, *Malone v. White Motor Corp.*, — U.S. —, No. 76-1184 (decided April 3, 1978) slip op. 2-3. The District Court in *Malone* noted: "Deferred funding of past service liability is a common feature of pension plans. In essence, past service liability is met by continued business operations and continued contributions by the employer to the pension fund. If the plan is terminated, the pension fund will not be increased and as a result some past service liability will remain unfunded," *White Motor Corp. v. Malone*, 412 F.Supp. 372, 374 (D.Minn.), *rev'd*, 545 F.2d 599 (C.A. 8), *rev'd sub nom. Malone v. White Motor Corp.*, — U.S. —, No. 76-1184 (April 3, 1978).

plan. *E.g.*, *Malone v. White Motor Co.*, *supra*; <sup>9</sup> *Alabama Power Co. v. Davis*, 431 U.S. at 590; *Fleck v. Spannaus*, No. 77-747, Brief of Appellant Structural Steel Co. at 17a. The Local 705 Trust Agreement so provides in Article 13 (A. 64, p. 7). While plans vary as to the time and extent of vesting, ERISA § 202 now sets certain minimum vesting standards.

An important variable which affects the ability of pension funds to pay benefits is the fact that contributions are made with respect to potential beneficiaries who never attain vested rights.<sup>10</sup> To the extent a particular plan has a given forfeiture or drop-out rate the amount of money available may be sufficient to pay benefits to those satisfying all the requirements of the plan, benefits may be increased or employer contributions may be reduced. See also, generally, Bernstein, *The Future of Private Pensions* (New York, N.Y., The Free Press of Glencoe, 1964), at 39-46; Allen, Melone & Rosenbloom, *Pension Planning* (Homewood, Ill., Richard D. Irwin, Inc., 1976) at 72-77.

Pension plans may also be divided into funded and unfunded plans. In an unfunded plan the employer disburses the benefits as they become due as a payroll cost. The beneficiaries must look solely to the employer's present ability to pay. Since ERISA this system is no longer available for pension plans of employers in interstate commerce or plans of employee organizations with members in interstate commerce. While ERISA provides for certain minimum funding standards for defined benefit plans, § 302, there are still a multitude of funding op-

<sup>9</sup> Section 6.17 of the White Motor Corp. plan stated: " 'No benefits other than those specifically provided for are to be provided under this Plan. No employee shall have any vested right under the Plan prior to his retirement and then only to the extent specifically provided herein.' " *Id.* slip op. p. 2, n. 2.

<sup>10</sup> See *e.g.*, *Walsh v. Schlecht*, 429 U.S. 401, 408-410; *Johnson v. Botica*, 537 F.2d 930, 935, 936 (C.A. 7); *Local Union No. 5, Sheet Metal Workers' International v. Mahoning and Trumbull County Building Trades Welfare Fund*, 541 F.2d 636 (C.A. 6).

tions open to complying employers. Under a funded plan, the employer makes annual contributions to a trust fund. Some plans are funded in whole or in part with the employer's own stock. In the instance of contributory plans, employee contributions may or may not be invested in the employer's stock, a difference which has significance under the federal securities laws.

Funded plans may be either insured or non-insured although some plans use a combination of the two. Under an insured plan, the employer enters into a contract with an insurance company (ordinarily a group annuity contract and sometimes individual insurance or annuity contracts for each employee). The employer pays contributions (also called premiums) to the insurance company which holds and invests the funds and agrees to disburse them for the purpose of paying the promised benefits to the employees in the manner provided by the plan and the contract. In many cases, the insurance company will assume a contractual liability directly to the employees, sometimes upon the retirement of each employee and sometimes at an earlier date, to assume the employer's obligations to pay the plan benefits. See also, generally, McGill, *Fundamentals of Private Pensions*, Pension Research Council, Wharton School, University of Pennsylvania (Homewood, Ill., Richard D. Irwin, Inc., 1975) at 225-284.

In a non-insured funded plan, contributions are held by the trustees, which may be a bank or trust company, or any other designee of the employer, or in the case of collectively bargained funds will usually consist of an equal number of employer and union designees. The trustees are responsible, in some instances pursuant to employer direction or concurrence, for the investment of the fund. Such investment often is accomplished through the vehicle of trust funds maintained by banks or separate accounts maintained by insurance companies expressly for that purpose. See also, generally, *id.* at 285-302.

## SUMMARY OF ARGUMENT

## I.

In *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 849 ("*Forman*"), this Court held:

"The primary purpose of the Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors. Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto."

The "economic reality" test which was thus reaffirmed is a principled standard designed to effectuate the Congressional intent to regulate certain transactions through the securities laws, but not others. But the Court of Appeals failed to heed *Forman's* fundamental teaching that the "focus of the Acts" constitutes a significant restriction on their coverage.

When an individual becomes or remains a participant in an involuntary non-contributory pension plan he is not in the capital market; he is in the labor market. As a wage earner and potential pension beneficiary, the employee is not an "investor" in any sense understood by Congress when it was protecting investors in the securities markets; he does not acquire anything which can reasonably be assimilated to any of "the many types of instruments that in our commercial world fall within the ordinary concept of a security" H.R. Rep. No. 85, 73d Cong., 1st Sess., 11 (1933), quoted in *Forman*, 421 U.S. at 847-848; nor does his acceptance of or remaining in covered employment give rise to a "purchase" and "sale"

of an interest or participation in the plan or the fund from which he may receive benefits. The 73rd Congress was surely able to distinguish between an individual's taking of and remaining on a job, and an individual's purchasing of a share of stock or otherwise placing capital at risk; and to differentiate pension funds—to which employers contribute in order that money will be available for distribution to their employees after a lifetime of labor—from the kinds of enterprise with whose financing it was then concerned.

*Forman* also teaches, by its disapproval of the Second Circuit's method in that case, that "economic reality" is distorted by fragmenting a complex transaction and then holding it to be subject to the securities laws because one element thereof bears a resemblance to other transactions which are covered. Here the Court of Appeals isolated from the employees' total working conditions a single "fringe benefit"—the contingent expectancy of receiving "pension payments [which] are predominantly rewards for continuous employment with the same employer." (*Alabama Power Co. v. Davis*, 431 U.S. 581, 594.) It also characterized the employee's participation in the pension plan on the basis of a single factor which increases the amount of money in the pension fund—its investment performance—although other factors are far more significant, namely, that money is contributed with respect to the labor of persons who will never receive any benefit, and that current contributions are far in excess of those made when the beneficiary was acquiring eligibility. The court also put aside other important determinants of the benefit, if any, which the participant will ultimately receive, such as his own compliance with the eligibility requirements, the award of past service credits, and the trustees' determination of how much can be paid, consistent with the interests of other participants. Each of these factors is entirely foreign to " \* \* \* the many types of instruments that in our commercial world fall

within the ordinary concept of a security.' " 421 U.S. at 847-848.

The Court of Appeals' opinion indulged freely in loose analogies, in denominating covered employees as "investors" who make "investments", and similar torturing of securities law concepts. Its need to do so reflects the incongruity of using those laws to vindicate a pension applicant's claim, which arises out of transactions which are in an entirely different universe of discourse than the transactions in the capital market of the enterprise system on which the Securities Acts focus.

## II.

A. The Court of Appeals' holding that a security is present was the product of a series of misconceptions concerning the economic reality of compulsory non-contributory pension plans. Central to its approach was its view that "employees are putting money into a fund for an employee's future use which he would otherwise be getting in his paycheck." (A. 224; see also, *e.g.*, A. 225, n.20, 227, 231). But the reality is otherwise. An employee does not part with money; he performs labor. The money which the fund receives is contributed by the employer for the benefit of the employee group as a whole; a particular employee cannot choose to receive it at the time he works and can ultimately receive any money from the fund only if he satisfies the eligibility requirements. Indeed, the contribution which an employer makes to a pension fund is not even necessarily measured by the hours of work performed by a particular employee. The UMW plan for example, is funded by royalties on tons of coal; see also, *Walsh v. Schlecht*, 429 U.S. 401, 409-410. Under no circumstances is the contribution the equivalent of money which the employee would otherwise earn. As this Court held in *Alabama Power Co. v. Davis*, 431 U.S.

581, "the 'true nature' of the pension payment is a reward for length of service." (*Id.* at 594).

The court referred throughout to "plaintiff's interest in the pension fund" or in the plan. This terminology is inaccurate and misleading. The pension trust here like most others explicitly provides that no employee "shall have any vested interest or right in the Trust Fund or in any payments from the Trust Fund" until he becomes eligible for benefits thereunder. It is, moreover, a group plan and all contributions received from the participating employers are pooled; there are no individual "accounts" for particular employees. An employee has only a contingent expectancy of future pension payments, in amounts to be determined in the future, if he ultimately satisfies the pension eligibility requirements. See *Alabama Power*, 431 U.S. at 594 and *Malone v. White Motor Co.*, — U.S. —, No. 76-1184, slip op. p. 12, discussing vesting requirements. The employee's expectancy can be defeated either by his quitting or discharge, or by his employer's going out of business, or refusal to continue to fund the plan.

Perhaps the most fundamental objection to the court's "profit" theory is that the investment gain of the fund does not necessarily redound to the advantage of the ultimate pension beneficiary:

"A participant in a defined benefit plan, particularly a compulsory non-contributory plan, does not expect to derive a profit in an economic or literal sense from employer contributions. The contrary is true. The participant expects to receive a retirement benefit whether derived from profits or from employer contributions, or from any other source for that matter. Even if the fund generates losses from investments, the participant wants, expects, and is entitled to his retirement benefits." Alef and Short, *op. cit.* p. 45, n. 30, *infra*.

The rate of the benefit which an individual receives as a pension is fixed by the pension plan trustees on the basis of considerations which may or may not include the fund's investment performance. It depends significantly on the employee's length of service with the employer, and the employer's or trustees' judgment of what level of payments is fair and necessary to provide some measure of financial security to the retiree. See *Alabama Power Co.*, 431 U.S. at 594. The actual amount received depends not only on the rate of payments but also on how long he lives in retirement.

B. 1. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, admonished against imposing liability under § 10(b) and Rule 10b-5 by "add[ing] a gloss to the operative language of the statute quite different from its commonly accepted meaning." *Id.* at 199. It distorts the "commonly accepted meaning" of those words to say that by performing labor an employee "purchases" an interest in a pension plan to which his employer contributes, even if that contribution is viewed as partial compensation for that labor.

2. The court's finding of a purchase and sale here conflicts with the "policy considerations" on which this court relied, *Blue Chip Stamps v. Manor Drug Stores* (421 U.S. 723, 737, 749). Recognizing plaintiff's cause of action would create the very "social cost[s]" identified in *Blue Chip*. (421 U.S. at 741). The holding that continuation in employment is a "purchase" throw[s] open to the trier of fact many rather hazy issues of historical fact the proof of which depend[s] almost entirely on oral testimony." (*Id.* at 743; see also *id.* at 746.)

An employee's decision to remain on a job for one more day is at least as amorphous a predicate for a right of action under the federal securities laws as an investor's decision to hold his investment one more day rather than sell it and buy something else. In determining whether to keep or quit his job, an employee considers a whole array of factors, and even if the employee believes that

the pension plan is undesirable for him because he is uncertain whether he will qualify, or for any other reason, he may have to remain on the job for lack of better alternatives. Compare *Manhart*, p. 9, *supra* slip op. p. 13, n. 30. And given the importance of oral testimony, further exemplified by the Court's reliance on Daniel's affidavit (A. 245, 246, n. 41), plan trustees would be put to the truly unenviable choice between the substantial expense of defending against securities law claims and subverting the plan's actuarial assumptions or providing pensions to an applicant who is ineligible under the plan's rules.

3. Prior to the decision below no court or agency had ever held that there is a "purchase and sale" under the securities laws when an individual accepts or remains in employment covered by an involuntary, noncontributory pension plan. Even the District Court found the "purchase and sale" in plaintiff's participation in union contract ratification. The SEC's 1971 *Institutional Investor's Study* described the legal status of pension plans, and dealt at length with the extent of their coverage under the securities laws. Of particular significance in this case was the following statement:

"(1) *Corporate pension and profit-sharing plans—*  
(a) *Plans not providing for voluntary contributions.*  
—In the case of plans \* \* \* where contributions to the funding medium consist of either employer money only or employee contributions which are required as a condition of employment, the Commission staff has taken the position that the *Securities Act* does not apply because there is no 'sale' or 'offer for sale' of a security." (3 *SEC Institutional Investor Study* at 996 emphasis added.)

This interpretation was based on "the absence of a volitional element on the part of the employee \* \* \*" (*id.*). The Study differentiated voluntary and contributory plans, which it discussed in the next subsection:

"In the situation where the employee may make voluntary contributions to the plan \* \* \* the absence-of-volition rationale cannot come into play. However, the Commission staff has in the past taken a no-action position 'that no question will be raised with respect to the registration of participations in a voluntary contributory pension, profit-sharing, or similar plan that does not invest in the securities of the employer company in an amount exceeding the company's contribution.'" (*Id.* at 997)

As Judge Tone recognized, the Study belies the SEC's contention, accepted by the majority, that its prior "no-sale" position was limited to the Act's registration requirements.

### III.

A. Congress has twice enacted legislation designed to protect the interests of participants and beneficiaries in noncontributory involuntary plans, and dealt therein with the precise problem of the nature and timing of disclosure to which plan participants and beneficiaries are entitled. On both occasions the SEC disclaimed either authority or expertise concerning collectively bargained pension plans, and it reinforced the Congressional understandings—first (prior to WPPDA of 1958), that employees were not at all protected by federal law with respect to information concerning pension benefits, and thereafter (prior to ERISA of 1974), that existing law was inadequate, in part because no law provided employees with sufficient information. At no time were the Congressional committees studying pension plans advised that the securities laws already obligated plan administrators or others to provide employees who obtain or choose to retain employment covered by a collectively bargained pension plan with information concerning that plan, or that those laws dealt in any manner with the relationship between such pension plans and their participants. The committees were told just the opposite. And

in both instances they legislated in light of their clearly expressed belief that the federal securities laws are inapplicable to that relationship.

The SEC was particularly active in the legislative process which led to the WPPDA. Acting SEC Chairman Andrew D. Orrick testified that "[t]he functions of the Securities and Exchange Commission are devoted to the regulation of the capital-securities markets . . . But the area covered by a bill on welfare and pension funds does not, as such, deal with the capital-securities markets." In his testimony and in a supplemental memorandum the SEC disclaimed interest in being given responsibility to administer the pending legislation. Against this background, Congress determined to regulate welfare and pension plans and to vest administrative responsibility in the Department of Labor rather than the SEC. See the Senate Report quoted by the court below, (A. 252, n.53).

At the outset of its investigation which led to ERISA the Senate Subcommittee had caused a detailed analysis to be made of all legislative regulation of pension plans, the results of which were set forth in the 1971 Interim Report and were then carried forward in subsequent committee reports in both bodies, in a summary entitled "*The Existing Law*". The Interim Report stated that "pension and profit sharing plans are exempt from coverage under the Securities Act of 1933 \* \* \* unless the plan is a voluntary contributory pension plan and invests in the securities of the employer company an amount greater than that paid into the plan by the employer." It also portrayed the SEC in a peripheral role and did not even mention the securities laws in the section it entitled "Legislative Regulation". The court below simply misread the Interim Report as it had misread the 1971 Institutional Investors Study with which the Interim Report was in full accord.

B. Our brief describes at considerable length the legislative history of the securities laws and administrative

practice thereunder as it pertains to pension plans. The single most important fact is that the Commission at no time asserted the authority to regulate involuntary non-contributory pension plans under the anti-fraud provisions or otherwise, and that its actual practice accords with the description which we have quoted from the Institutional Investors Study. "Failure to use such an important power for so long a time indicates to us that the Commission did not believe the power existed." *Federal Power Commission v. Panhandle E.P.L. Co.*, 337 U.S. 498, 513. See also *United States v. Enmons*, 410 U.S. 396, 408-410. Of this the court below said nothing.

For purposes of this summary, we shall confine ourselves to a few additional highlights.

1933. Contrary to the court below, by 1933 employee pension plans were by no means a "rarity" (A. 241): they were a significant economic phenomenon affecting over 3,500,000 employees of 360 companies, a phenomenon whose importance Congress had specifically recognized in revenue legislation as early as 1926.

1934. The court below relied on Congress' rejection of Senator Hastings' proposed amendment to Section 4(1) of the 1933 Act which would have given the benefit of the "non-public offering exception" to *employees' stock investment plans*. Since such plans are merely vehicles for the employers distribution of his own stock and since there was no mention of pension plans in the language or legislative history of the proposed amendment, this Congressional action says nothing about compulsory or noncontributory plans.

1940. The court below erred in its view that pension plans are "congruent with" employees' securities companies and therefore are investment companies regulated under the Investment Company Act of 1940 unless exempted. In fact, pension trusts (or plans) were expressly excluded from the definition of investment companies by § 3(c) (13) of the 1940 Act, whereas "employees' securi-

ties companies" were defined in § 2(a) (13) as an "investment company," which the SEC could exempt if it satisfied the conditions set forth in § 6(b) of that Act. This distinction was understood by the SEC in a 1941 decision, *Electrical Securities Corporation*, 10 SEC Jud. Dec. 648. That pension trusts were not considered to be investment companies is shown also by their omission from the comprehensive SEC report which was the predicate for the 1940 Act, and which listed by name "all the investment companies known to the Commission."

1941. There were two significant developments in 1941. First, in September the SEC published two opinions of Assistant General Counsel Davis. Second, later that year Commissioner Purcell testified before the House Committee in connection with amendments to the 1933 Act proposed by the Commission. The court below misinterpreted the opinions and the testimony, both of which actually confirm our views (1) that the SEC did not then consider involuntary and noncontributory pension plans to be securities and (2) that the Commission's no-sale theory with respect to such plans was based on its interpretation of the statute rather than any administrative practice limited to its registration requirements.

The position stated in the Davis opinions was:

1. Certain types of voluntary contributory plans involve the sale of a security and are subject to the Act.
2. Compulsory plans and non-contributory plans are not subject to the Act because they do not involve an offer or sale within the meaning of the Act.

"[I]t is because of the language of Section 2(3) that we have taken the position in the past that no 'offer' or 'sale' is involved in the case of a non-contributory plan, where the employees are not requested to make any contributions, or in the case of a compulsory plan, where there is no element of volition on the part of employees whether or not to participate and make contributions." (Op. cit. p. 103, *infra*.)

Mr. Purcell's testimony was in accord. He did not claim that pension plans generally constitute investment contracts. Rather, he took that position only with respect to employee investment plans to which employees contribute their own money (supplemented in some instances by employer contributions) and perhaps only those plans which in turn are invested in the employer's securities. Copious quotation from his testimony in our brief shows that he considered only voluntary contributory plans to be subject to the Act and that compulsory and noncontributory plans were not so subject. See, *e.g.* 1941 Hearings, 887-888, 895-897, 903.

*1941-1970.* After the SEC failed in its 1941 effort to gain express statutory authority over voluntary contributory plans, it evidently abandoned further efforts to apply the Securities Act to most plans of that type. In 1953 letters from the Assistant Director of the Commission's Division of Corporation Finance formally announced the much narrower policy that registration was required only for contributory plans which used employee contributions to purchase employer securities. The conclusion in the 1941 opinions that compulsory noncontributory pension plans do not involve a sale and were not subject to the Securities Act was expressly reaffirmed as current staff policy in letters in August and November 1962.

*1970.* The Court of Appeals placed heavy reliance on an amendment made to § 3(a)(2) of the 1933 Act by § 27(b) of the Investment Companies Amendments Act of 1970 (the "1970 Act"). According to the court, Congress therein exempted "interests in employee pension funds \* \* \* from the registration requirements of Section 5 of the 1933 Act if the employee pension fund was maintained by a bank or in a separate account maintained by an insurance company." (A. 236) The court drew from that interpretation two propositions which were critical to its ultimate judgment. *First*, that Congress thereby "evidenced agreement with the SEC's position that interests

in pension funds are securities"; and *second*, that by virtue of those amendments nearly all pension funds are exempt from registration. (A. 236-238, 252, 258.)

The second proposition is wrong because contrary to the assumption of the court below that 96% of all pension funds are bank maintained and hence exempt from registration by reason of the 1970 amendment (A. 258, n.61), the SEC's own statistics show that funds with assets of at least \$50 billion would be nonexempt from registration under the court's interpretation. Because the court did not realize the true consequences of its interpretation, it did not face up to a question which we submit is unanswerable: Why would Congress exempt from registration interests in pension funds maintained by a bank or in a separate account maintained by an insurance company and yet subject interests in all other pension funds to registration?

The first proposition is wrong because the 1970 amendment did not address the relationship between employee participants and pension plans or trusts at all, but rather only the relationship between banks or insurance companies which offer bank trust funds or separate insurance accounts as investment vehicles for pension fund assets and those who are responsible for determining the manner in which such assets will be invested. This interpretation explains why the phrase "maintained by a bank \* \* \*" is used in the 1970 amendment, whereas, as noted, the court's interpretation makes no practical sense. Moreover, our view is confirmed by the legislative history which in view of the importance placed upon the point by the court below the brief is constrained to describe in regrettably elaborate detail.

It is common ground that through the passage of the bill by the Senate in 1969 its purpose was to clarify the status of certain commingled investment accounts maintained by banks and insurance companies. As reported by the House Subcommittee, however the bill contained an

added phrase "single or" to precede the phrase "collective trust fund maintained by a bank." This version, according to the court, "altered the focus of the exemption to encompass interests in the underlying pension funds." (A. 239).

We submit the court was mistaken for several reasons of which we set forth the most important. *First*, the description of § 27(b) in the House Committee Report was identical to the earlier Senate Committee's Report. The House Committee did not even mention the change. *Second*, and we believe independently decisive, a colloquy occurred on the House floor between Congressman Springer, the ranking minority member and Congressman Moss, the chairman of the subcommittee which explained the change. (116 Cong. Rec. 33287, quoted in full at pp. 126-127 *infra*). This deliberate and authoritative colloquy, far from stating that there had been a significant change in "focus", declared that the House bill differed from the Senate bill "slightly", in that "a single trust maintained by a bank where the trust assets were *not* commingled with those of other qualified trusts would *also* be exempted from registration" under the securities laws; that is, they would be treated like "collective trusts maintained by a bank" under the Senate bill. *Third*, the court cites no reference in the legislative history which shows that Congress even knew of the existence of the administrative practice which the court believed was being codified; this omission is not due to oversight, but was unavoidable because there is no such reference. *Fourth*, the court does not even reflect upon the inherent unlikelihood of its scenario, wherein Congress changed the whole focus of major legislation on the basis of a letter from one attorney, without hearing from any of the numerous parties who would be affected, and without spelling out in debate or committee report precisely what it had done. *Finally*, the court's interpretation of the 1970 amendment is flawed by its failure to recognize that the 1971

Institutional Investor Study describes an administrative practice which, insofar as is pertinent here, is the precise opposite of that which the court says was codified in 1970, see p. 3, *supra*. We submit that the 1970 Amendment, properly interpreted, has nothing to do with the issue in this case.

C. The majority below accepted the SEC's revisionist history, of which Judge Tone perforce said: "The Commission has not been as candid as we might have hoped in acknowledging and explaining its change in position." (A. 260). In consequence, the majority gave the Commission's present views far greater weight than they deserve under the circumstances (see *e.g.*, *Forman*, 421 U.S. 837, 858, n.25, followed in *General Electric Co. v. Gilbert*, 429 U.S. 125, 143; *Piper v. Chris-Craft Industries*, 430 U.S. 1, 41 n.27) and insufficient weight to the position which the SEC took in the first forty years.

But the paramount importance of this history stems from the fact that Congress has twice enacted pension legislation in reliance on the SEC's existing interpretation. Even as the SEC "is not now free" to assert that the securities laws regulate this subject, so, too, is the courts' freedom circumscribed, for the principled basis of this rule of construction is not that the agency should be estopped, but that the manifested Congressional will should be enforced. Thus even if the securities laws are so elastic that the courts could permissibly have applied them to reach involuntary noncontributory pension plans absent intervening Congressional action, the enactment of WPPDA and ERISA under the circumstances detailed herein forecloses this choice. These laws embody Congressional policies concerning the regulation of pension plan disclosure which the courts may not override and frustrate by rejecting the assumptions on which Congress justifiably proceeded. Compare *Califano v. Sanders*, 430 U.S. 99, 105-108.

## IV.

In *Los Angeles Dept. of Water & Power v. Manhart*, — U.S. —, No. 76-1810 (decided April 25, 1978), this Court held that “\* \* \* the rules that apply to [pension] funds should not be applied retroactively unless the legislature has plainly commanded that result” (slip op. p. 18).

The Court noted that in enacting ERISA Congress “underlined the importance of making only gradual and prospective changes in the rules that govern pension plans.” *Id.*, n. 40.

Here, as in *Manhart*, “this is apparently the first litigation” asserting the rule of pension management adopted below, and that rule “represents a marked departure from past practice.” (Slip op. p. 19.) “Retroactive liability could be devastating for a pension fund” and “[t]he harm would fall in large part on innocent third parties” (slip op. p. 19), pensioners and current employees. Thus, precisely the same policy and practical considerations militate here also in favor of treating any such rule as only a standard for behavior henceforth and not as a basis for monetary recovery on account of past conduct in reliance upon rules reasonably believed established.

*Manhart* denied retroactive recovery although this Court had held that in suits under Title VII of the Civil Rights Act of 1964 there is a “presumption in favor of retroactive liability [which] can seldom be overcome.” (Slip op. p. 16 citing *Albemarle Paper Co. v. Moody*, 422 U.S. 405. The “considerations of policy” found controlling in *Manhart* have even more force where the granting of any private remedy is due only to a “judicially implied cause of action” (*Blue Chip*, 421 U.S. at 736; see also *id.* at 737 and 749.) The inequity of imposing financial liability under the securities laws for noncompliance with disclosure standards that were generally understood to be non-existent is well articulated in *Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1291-1294 (C.A. 2, Friendly, J.)

## ARGUMENT

**I. EMPLOYEE PARTICIPATION IN A COMPULSORY NONCONTRIBUTORY PENSION PLAN IS NOT THE KIND OF TRANSACTION WHICH CONGRESS SOUGHT TO REGULATE BY ENACTING THE FEDERAL SECURITIES LAWS.**

One knowledgeable court has observed:

The securities laws in question, designed to safeguard the integrity of investment decisions, have been in operation for over forty years. Yet until the 1975 decision in *Daniel* \* \* \* no court had ever held, nor apparently had anyone including the SEC the temerity to argue that an interest in an involuntary, noncontributory pension or health benefit plan was covered by the securities laws. Congress has repeatedly indicated its belief to the contrary.<sup>11</sup>

The novelty of this case is not due to a paucity of litigation by disappointed pension applicants. Since 1933 many employees have been denied pensions, because they did not meet eligibility criteria, because the plan was insufficiently funded, because the employer shut down a plant or for other reasons. Suits have been brought under a variety of common law and statutory theories; in doubtless many other instances claimants have been advised against suit for want of any colorable basis. Nor can the absence of such claims be laid to a lack of will or resourcefulness on the part of the securities bar or practitioners generally. On the contrary, it reflects a common—and entirely correct—appreciation that the securities laws are not a catch-all for claims of alleged frauds of commission and omission. They regulate an important, but nonetheless discrete segment of our economy.

<sup>11</sup> *Robinson v. United Mine Workers of America, etc.*, 435 F.Supp. 245, 247 (D.D.C., Gesell, J.) (footnote omitted).

As this Court held in *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 849 ("*Forman*"):

"The primary purpose of the Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors. Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto."

In *Forman* the Court decided that the type of transaction before it, in which the purchasers were interested in acquiring housing rather than making an investment for profit was not within the scope of the federal securities laws. (*Id.* at 859-860.) The reasoning of *Forman* requires reversal of the decision in this case.

The heart of the matter is that when an individual becomes a participant in an involuntary non-contributory pension plan he is not in the capital market; he is in the labor market. In his capacity as wage earner and potential pension beneficiary, the employee is not an "investor" in any sense understood by Congress when it was protecting investors in the securities markets, and he does not acquire anything which can reasonably be assimilated to any of "the many types of instruments that in our commercial world fall within the ordinary concept of a security" H.R. Rep. No. 85, 73d Cong., 1st Sess., 11 (1933), quoted in *Forman*, 421 U.S. at 847-848. And it likewise stretches these laws far beyond their original scope to hold, as the Court of Appeals did, that an individual's acceptance of or remaining in covered employment gives rise to a "purchase" and "sale" of an interest or participation in a pension plan.

*Forman* adhered to the methodology of the earlier decisions in which the presence of a "security" was in issue. Not form but "economic reality" has been the touchstone, and it was economic reality that led to the determination that a security was present in the cases from *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, through *Tcherepnin v. Knight*, 389 U.S. 332. That same test led in *Forman* to the opposite conclusion because the transaction before the Court was "not within the scope of the federal securities laws" (*id.* at 860). Thus, *Forman* adds the insight that "economic reality" is not a result-oriented slogan invented for the benefit of the SEC and private plaintiffs; it is a principled standard designed to effectuate the Congressional intent to regulate certain transactions through the securities laws, but not others. Respect for the Congressional intent compels the conclusion that the securities laws are inapplicable where those realities show, as they did in *Forman*, and as they show here, that the transaction at issue is not within "[t]he focus of the [Securities] Acts." (421 U.S. at 849). *Forman* applied to the securities laws the principle that in construing legislation the courts must, in Learned Hand's words, "reconstitute the gamut of values current at the time when the words were uttered."<sup>12</sup>

*Forman* also identifies the values of the 73rd Congress. It was concerned with ending abuses "in the capital market of the enterprise system" which had, it was widely believed, caused the collapse of the securities markets and of many enterprises which were fueled by the capital generated through those markets, and, in turn, the Great Depression. To assert that interests in noncontributory involuntary pension plans were within "the focus" of the legislation that resulted is not to reconstitute those values, but to rebel against them. The 73rd Congress knew the

<sup>12</sup> Letter of Judge Learned Hand, requoted in *Woodwork Manufacturers v. NLRB*, 386 U.S. 612, 620.

difference between labor and capital; legislation to protect the worker was also on its agenda, and became a reality in the 74th Congress as the National Labor Relations Act, even as when Congress much later turned its attention to protect workers' pension expectancies, it did so through legislation addressed to that subject and administered—its tax aspects aside—by the Department of Labor. Although it was acutely aware that for the average individual his capacity to work is his only source of livelihood, it was able to distinguish between an individual's taking of and remaining on a job, and an individual's purchasing of a share of stock or otherwise placing capital at risk. And it would have recognized—if the thought had not been so remote from its concerns that the idea was never broached—that a pension fund to which employers contribute in order that money will be available for distribution to their employees after a lifetime of labor is not the kind of enterprise whose managers strive to achieve earnings for distribution in proportion to the capital provided, and whose financing was the subject of the securities laws.

*Forman* also teaches, by example, that "economic reality" is not preserved by taking a complex transaction, breaking it into small parts and then determining that the totality is covered by the securities laws because one element bears a resemblance to other transactions which are covered, but whose other characteristics are entirely different. Precisely such fragmentation was the line of analysis there advocated by the SEC in misplaced reliance on *SEC v. United Benefit Ins. Co.*, 387 U.S. 202.<sup>13</sup> So here, the economic reality of the transaction is doubly distorted by characterizing an individual's acceptance and performance of a job which is covered by a collectively bargained pension plan as the "purchase" of a "security".

<sup>13</sup> See Brief for the Securities and Exchange Commission in *Forman*, No. 74-157, Oct. Term, 1974, p. 17.

First, it necessitates isolating from the employees' total working conditions the contingent expectancy of receiving "pension payments [which] have some resemblance to compensation for work performed," but which "are predominantly rewards for continuous employment with the same employer." (*Alabama Power Co. v. Davis*, 431 U.S. 581, 592, 594.) Common sense indicates that when a person takes a job the predominant considerations are the nature of the work and the rate of pay; the possibility of future pension rights is one of a number of what are commonly referred to as "fringe benefits" which also include vacation pay, health and welfare benefits and with increasing frequency, group legal services.<sup>14</sup>

Second, it characterizes the employee's participation in the pension plan on the basis of a single factor which increases the amount of money in the pension fund—its investment performance—to the exclusion of other factors which are more important, the use of a pooled fund where contributions are made with respect to the labor of individuals who will never become beneficiaries, and the advantage of current contributions to the fund far in excess of those made when the beneficiary was acquiring eligibility. And it also excludes consideration of other more important determinants of the benefit, if any, which the participant will ultimately receive, such as the participant's compliance with the eligibility requirements, the award of past service credits, and the trustees' determination of how much can be paid, consistent with the interests of other participants. Each of these factors is entirely foreign to "the many types of instruments that in our commercial world fall within the ordinary concept of a security." 421 U.S. at 847-848. While the SEC argued in *Forman* that "an investment contract type of

<sup>14</sup> See LMRA §§ 302(c)(5), (7) and (8), 29 U.S.C. §§ 186(c)(5), (7) and (8).

security may exist where investors are motivated by any significant economic inducement",<sup>15</sup> that view did not prevail.

In driving to the result that the securities laws applied, the Court of Appeals was evidently prompted by its strong feeling that such coverage is both necessary and desirable. (A. 232, 241-242, 244, n.40, 246, n.41, 254-259). Not only is this contrary to *Forman* (421 U.S. at 859, n.26), but it is particularly inappropriate since Congress addressed the disclosure obligations of pension plans with legislation enacted in 1958 and again in 1974. Coverage under the securities laws does not result from the undoubted importance of the pension to the employee,<sup>16</sup> nor from the importance of pension funds in the capital market (A. 232), for the transactions by which those funds are invested are, of course, within the coverage of the securities laws.

Again, it is only by ignoring economic context, by fragmentation, by allowing analogy to proceed wherever the mind may find a way to go, and thereby losing sight of

<sup>15</sup> Brief for the Securities and Exchange Commission, No. 74-157, Oct. Term, 1974, p. 15. See also Brief for Respondents, quoted at n. 16 *infra*.

<sup>16</sup> Compare the plaintiffs-respondents' brief in *Forman*:

"It cannot be seriously urged that plaintiffs, all people of limited means, willingly invested what for many was their life savings without any hope of financial gain. Defendants appear to contend that plaintiffs paid out \$32,303,200 in hard cash merely to further defendants' cooperative effort. Plaintiffs, however, made their purchases for the total package which defendants offered: stock ownership in a giant cooperative real estate enterprise, tax deductions, the possibility of dividend income, and decent living accommodations at a real dollar saving. Defendants' attempt to deprive plaintiffs of the protection of the federal securities laws by artificial formal distinctions between kinds of economic inducements was properly rejected by the Court of Appeals" (Brief for Respondents, No. 74-157, Oct. Term, 1974, p. 27.)

that to which the securities laws were directed, that non-contributory pension plans can be analogized to pyramid schemes,<sup>17</sup> stock options,<sup>18</sup> mutual funds<sup>19</sup> and variable annuities,<sup>20</sup> and a union member's vote on ratification of a collective bargaining agreement analogized to a stockholder's vote on approving a statutory merger which results in the loss of statutory appraisal rights.<sup>21</sup>

Finally, economic reality is only camouflaged by calling a covered employee an "investor" who makes "investments" even if that is done over and over and over again. From there, the mind readily progresses to calling a contingent expectancy of a pension benefit a "security" (A. 224), the acceptance or continuation of covered employment a "purchase" (A. 245), the difference between the contributions which are hypothetically attributable to an individual's employment and the value of his pension a "profit" (A. 226), and the possibility that the employee will never obtain a pension his "risk of loss" (A. 254), and ultimately to calling the initial formation of a pension plan "primary distribution" and the amendments thereto "secondary distributions", thereby providing the "conceptual predicate" for bringing the plaintiff's claim within § 10(b) of the 1934 Act. (A. 249-250, n.46.)<sup>22</sup> Such word play not only contravenes the

<sup>17</sup> See A. 226 discussed at p. 49, *infra*.

<sup>18</sup> See A. 227 discussed at p. 50, *infra*.

<sup>19</sup> See A. 231, 234, 235, 241 discussed at p. 43, n. 29, *infra*.

<sup>20</sup> See A. 226-227, 231 discussed at p. 43, n. 29, *infra*.

<sup>21</sup> See A. 244-45 discussed at pp. 63-67, *infra*.

<sup>22</sup> In securities laws parlance, a "primary distribution" is any sale by the "issuer", which, under the Court of Appeals construct would be the defendant trustees. A "secondary distribution" does not refer to additional sales of securities by the same issuer but to resales by controlling persons of outstanding securities which were

teaching of *Forman* (421 U.S. at 849) but "ignore[s] the ancient wisdom that calling a thing by a name does not make it so" (*Madison School District v. Wisconsin Employment Relations Commission*, 429 U.S. 167, 174).

The Court of Appeals' need to torture securities law concepts reflects the incongruity of utilizing those laws to vindicate the claim of a pension applicant, for that claim arises out of transactions of an entirely different purpose and character than transactions in the capital market of the enterprise system on which the securities acts focus. They are simply not in the same universe of discourse.

## II. BECAUSE THE COURT MISCONCEIVED THE ECONOMIC REALITY OF A COMPULSORY NONCONTRIBUTORY PENSION PLAN, IT ERRONEOUSLY CONCLUDED THAT THERE WAS A PURCHASE AND SALE OF A SECURITY.

The Court of Appeals' primary error was its failure to recognize the fundamental economic reality that an employee's coverage under a compulsory noncontributory pension plan does not render him an investor in the capital market for whose protection the securities laws were enacted; in consequence, it subjected plaintiff's participation in the Local 705 plan to the same securities law analysis which the courts have traditionally followed in determining whether a commercial transaction involves the sale of a security. And in undertaking this inquiry

previously issued; since "interests" in a pension plan are nontransferable and nonnegotiable, there can be no secondary distribution. For that matter there can be no resales of any kind and for that reason alone, there would appear to be no liability under § 10(b) of the 1934 Act, as the court below implicitly recognized when it created its strained and erroneous primary-secondary dichotomy. As to the nonexistence of a private cause of action for a violation of § 17(a) of the 1933 Act we adopt the position in the point III of the Local 705 brief.

the court's misperceptions of this economic reality resulted in its erroneous conclusions that "the elements of the *Howey* rule [for finding an 'investment contract'] are present here" (and hence there is a security within the meaning of the federal securities laws) (A. 221), and that an employee's performance of services in an employment covered by a compulsory, noncontributory plan involves a "purchase" and "sale" (A. 242-247).

### A. There Is No "Security."

#### 1. An Employee Does Not "Invest" Money In A Compulsory Noncontributory Plan.

The court below said: "Realistically speaking, employees are putting money into a fund for an employee's future use which he would otherwise be getting in his paycheck" (A. 224, see also, *e.g.*, A. 225, n.20, 227, 231-232). But the reality is otherwise. An employee does not part with money; he performs labor. The money which the fund receives is contributed by the employer for the benefit of the employee group as a whole; a particular employee cannot choose to receive it at the time he works and can ultimately receive any money from the fund only if he satisfies the eligibility requirements. The Court of Appeals has simply obliterated the essential differences between involuntary noncontributory plans and voluntary contributory plans. Its description also disregards a basic element of all collectively bargained plans, namely that they are negotiated by a union as representative of the entire group, rather than of any individual. As the court said in *Robinson*:

"The miners cannot be said to have 'invest[ed] \* \* \* money' within the meaning of *Howey*, for all contributions are made by the operators on a per-tonnage basis, and miners have no power to increase or de-

crease payments or to convert them to personal use." (435 F. Supp. 247).<sup>23</sup>

The miner example is indeed instructive. Employer contributions to the UMW health, welfare and pension plans are measured by tons of coal produced, which, of course, can in no way be allocated to the work performed by any particular miner and under other agreements. So too, in *Walsh v. Schlecht*, 429 U.S. 401, payments were made to multiemployer funds in part on the basis of labor performed by individuals who, because they work for non-signatory employers, can never be eligible, *id.* at 409-410. Under some single employer agreements and many non-bargained plans the amount of the contribution is not predetermined at all.

In short, the contribution which an employer makes to a fund may or may not be measured by the hours of work performed by a particular employee, but to the extent that it is, it is a matter of convenience and (in the case of multiemployer plans) equitable allocation of obligations

<sup>23</sup> The court below sought to distinguish *Robinson* as follows:

"Unlike *Daniel*, where Local 705 members could affect the employers' payments into the pension fund or the allocation of contributions between pension fund payments and current wages by failing to ratify a given contract with set contribution levels, the *Robinson* plaintiffs were powerless to increase or decrease payments or convert them to their personal use." (A. 229).

But Judge Gesell said not that "the *Robinson* plaintiffs [who were the miners' dependents and survivors] were powerless", but that the "miners have no power \* \* \*." And this Court can take judicial notice that miners in the UMW also enjoy the ratification rights which members of the IBT have. Thus, there is not even a factual difference in the situations, even if the fact on which the court below seized could be deemed relevant.

among employers. Under no circumstances is the contribution the equivalent of money which the employee would otherwise earn. And it is of course wholly artificial and arbitrary to attempt to quantify the amount attributable to an employee's work and thereupon to assert that "a Local 705 member invests \$1,248 per year through his employer contributions into that fund." (A. 231) Far more realistic was this Court's perception of compulsory noncontributory pension plans in *Alabama Power Co. v. Davis*, 431 U.S. 581. While the Court recognized "that pension payments should have some resemblance to compensation for work performed" and that "[f]unding a pension program is a current cost of employing potential pension recipients, as are wages", it concluded "that the 'true nature' of the pension payment is a reward for length of service." (*Id.* at 592-593).<sup>24</sup>

<sup>24</sup> See also Comment, *Application of the Federal Securities Laws to Noncontributory, Defined Benefit Pension Plans*, 45 U. Chi. L.Rev. 124, 142-143 (1977):

"The *Alabama Power* opinion provides the more accurate portrayal of noncontributory pension plans. The relationship between pension benefits and forgone wages is tenuous at best. Elimination of a pension plan would not necessarily produce an increase in current employee compensation. The vesting provisions generally present in pension plans tend to promote personnel stability by providing an incentive for employees to remain with their employer. As the Court said in *Alabama Power*, 'By rewarding lengthy service, a plan may reduce employee turnover and training costs and help an employer secure the benefits of a stable work force.' One of the benefits of personnel stability may be increased employee productivity, and it is conceivable that the reduction in training costs and higher productivity might actually "pay" for some pension plans.

"Even if elimination of pension plans would free some resources, it is not clear, especially in view of the tax advantages of pension arrangements, that those resources would necessarily be passed on to employees in the form of increased wages." (footnotes omitted)

## 2. *There Is No Employee "Interest".*

Throughout its opinion the court below refers to the "plaintiff's interest in the pension fund" or in the plan.<sup>25</sup> While it is convenient, for want of a better term, to describe a participation in a pension plan, and the contingent expectancy of becoming a beneficiary as an 'interest', that word is highly misleading insofar as it conveys either the notion of a legal right or of something akin to a share of stock. The pension trust here, like most others, is quite explicit in providing that no employee "shall have any vested interest or right in the Trust Fund or in any payments from the Trust Fund" until he becomes eligible for benefits thereunder. (See A. 64, p. 7, Trust Agreement, Article 13.)

It is, moreover, a group plan and all contributions received from the participating employers are pooled. There are no individual "accounts" for particular employees, and no employee has any claim upon or right in any portion of the pooled fund until he may ultimately become entitled to a pension. Although contributions are made for each week of work by each employee in the covered group, no employee receives anything of any present economic value by reason of such contributions. All he has is a *contingent expectancy* of future pension payments, in amounts to be determined in the future, if he ultimately satisfies the pension eligibility requirements determined by the trustees selected by the union and the employers.

In response to the identical submission below (IBT Br. 18) the Court of Appeals responded:

"[M]ere contingent expectancies are the rule rather than the exception in the equity markets. Profits in an equity security require that the market value plus accrued dividends of a stock be greater than the stockholder's cash basis. Thus profits are con-

<sup>25</sup> *E.g.*, A. 219, 230, 234, 235, 236, 242, 245, 259.

tingent on the successful operation of the common enterprise, there the issuing corporation." (A. 224)

But while a stockholder is not *assured of a profit* unless the enterprise is successful, even if it is unsuccessful he does own a present share of the enterprise, stock which he can sell for *some* money as long as the corporation is in existence, at least short of its bankruptcy. On the other hand, a participant in a pension plan can never convey any "interest" therein, no matter how successful the pension fund is in accumulating "earnings." Before he has satisfied the eligibility requirements for vesting he has nothing, and any pension he receives (or lesser right under some plans) is not transferable. Although the *Robinson* court used the word "interest", it was not thereby misled:

"As in *Forman*, interests in the Trust are inalienable, and any surplus will be converted into extended benefits for all rather than invested for the individual miner's profit." (435 F. Supp. at 247.)

The court below acknowledged that the analogy it drew between covered employment before benefits vest and the situation of a stockholder forced to sell his stock at a net loss "is not exact", but it regarded the difference to be immaterial:

"[W]e think that a right to receive benefits, received as a form of compensation and not subject to unilateral withdrawal by the pension trustee or the employer, is a sufficient interest to constitute a security, even though it will only mature upon the happening of certain events in the future." (A. 224)

But here again the court erred, because the right to receive benefits is subject to unilateral withdrawal by both pension trustees and the employer.<sup>26</sup> The broad power of

<sup>26</sup> ERISA limits the powers described in this paragraph but not sufficiently so that it would affect the analysis even if plaintiff could assert any rights under ERISA.

pension trustees to establish and modify pension eligibility requirements is well established.<sup>27</sup> And there are many ways in which the employer can effectively destroy the potential eligibility of some or all of his employees. Such action is completely unilateral where the employees are unrepresented; and even where the employees are represented, it is elementary that the employer is not obligated to acquiesce in the union's demands. See *e.g.*, *Porter Co. v. N.L.R.B.*, 397 U.S. 99, 109. Thus, where the obligation to contribute to the fund is established by collective bargaining, the employer can withdraw from the plan by agreement with the union (if it determines this to be in the employees' interest) or, if the union objects, by succeeding in a test of economic strength. Moreover, this Court has recognized the employer's unilateral right to go out of business, *Textile Workers v. Darlington Mfg. Co.*, 380 U.S. 263, which would likewise put an end to that employer's funding of a single-employer plan or contributing to a multiemployer fund. So, too, the cases are unfortunately legion where an employer has shut down a plant, thereby depriving many employees of their jobs and their pension expectations as well.<sup>28</sup> And of course the employer can foreclose an individual employee from ever attaining eligibility by discharging him, which he may do unilaterally, except insofar as a collective bargaining agreement restricts the exercise of that power.

<sup>27</sup> See, *e.g.*, *Local Union No. 5, Sheet Metal Workers International v. Mahoning and Trumbull County Building Trades Welfare Fund*, 541 F.2d 636, 639 (C.A. 6); *Johnson v. Botica*, 537 F.2d 930, 935 (C.A. 7); *Pete v. United Mine Wkrs. of Am. Welf. & R. F.*, 517 F.2d 1275, 1283 (C.A.D.C.); *Gomez v. Lewis*, 414 F.2d 1312, 1314 (C.A. 3).

<sup>28</sup> See, *e.g.*, *Malone v. White Motor Company*, *supra*; *Dwyer v. Climatrol Industries, Inc.*, 544 F.2d 307 (C.A. 7), *cert. denied*, 430 U.S. 932; *Craig v. Bemis Co., Inc.*, 517 F.2d 677 (C.A. 5); *Knoll v. Phoenix Steel Corp.*, 465 F.2d 1128 (C.A. 3), *cert. denied*, 409 U.S. 1126; *Baake v. General American Transportation Corp.*, 351 F. Supp. 962 (N.D. Ill.).

In short, the critical fact is that an employee obtains no rights to any lesser benefit until he has satisfied the vesting requirements established under the pension plan (see *e.g.*, *Alabama Power*, 431 U.S. at 593-594; *Malone*, *supra*, slip op. p. 12), establishes that the term "interest in a pension fund" conveys an image which does not reflect economic reality. See also p. 52, *infra*.<sup>29</sup>

### 3. There Is No "Profit" In The Howey-Forman Sense.

a. The Court of Appeals determined that a pension plan participant obtains "Profits from the Efforts of Others" (A. 226) on the following theory: "It is conceded that the expected payout to a beneficiary will exceed the contributions made by the employer on the employee's behalf (the union member's investment). The resulting gain would commonly be termed a profit" (*id.*). There are, however, several independent reasons why the pension fund does not generate profits in the *Howey-Forman* sense (*id.*).

<sup>29</sup> The court's hypostatization of an "interest in a fund" was apparently the first step to the court's assimilating pension funds to mutual funds and variable annuities. But there are many differences between these investments and participating in a pension fund of which we shall mention some of the most salient. A participant in a pension fund does not contribute specified sums of money, he may not sell, trade or redeem his interest, he does not have a proportionate share of the underlying portfolio and he does not entrust his personal capital to the pension plan administrators; moreover, the amount of his benefit is fixed by the trustees on the basis of numerous considerations which do not include the specific amount of money paid in because of his labor, but do include many factors, of which investment income is only one, as we shall elaborate in the next subsection.

The Court of Appeals also observed that former SEC Chairman Cohen "commented on the similarities between a pension fund and a mutual fund investment." (A.235). But Mr. Cohen also commented on the differences, including that: "Unlike the mutual fund investor, the employee's investment is usually mandatory. It comes with the job . . ." 1972 Hearings cited at p. 76, n. 68, *infra* at p. 231.

Perhaps the most fundamental objection to the Court's "profit" theory is that the investment gain of the fund does not necessarily redound to the advantage of the ultimate pension beneficiary, since in a deferred benefit plan such as this the amount of the benefit which an individual receives as a pension is fixed by the pension plan trustees on the basis of considerations which may or may not bear a significant relation to the fund's investment performance. The point is well made in one critique of the decision below:

"It appears, though, that the court and the SEC fail to distinguish between two inherently different concepts: The defined benefit plan and the defined contribution plan. In the defined contribution plan (such as a profit-sharing plan and money purchase pension plan), the participant is assigned an account and this account is credited with his pro rata portion of employer contributions. The profits which are generated on his account balance determine the benefit which the participant will receive some time in the future when distribution takes place. The amount of the participant's benefit will be in direct proportion to the profit or loss generated by the fund. The defined benefit plan, on the other hand, does not allocate employer contributions to accounts of participants and, in fact, participants do not have an undivided interest in plan assets. The participants' sole interest in the plan is a predetermined level of accrued benefits normally payable on retirement. A participant in a defined benefit plan, particularly a compulsory non-contributory plan, does not expect to derive a profit in an economic or literal sense from employer contributions. The contrary is true. The participant expects to receive a retirement benefit whether derived from profits or from employer contributions, or from any other source for that matter. Even if the fund generates losses from in-

vestments, the participant wants, expects, and is entitled to his retirement benefits."<sup>30</sup>

The court below dismissed this argument out of hand: "That this profit element is fixed because pension payments are set at specific levels from time to time is wholly immaterial to gain being profit in the *Forman* sense. A number of instruments which all would concede to be securities (bonds, debentures, etc.) are fixed return." (A. 227, n. 23). But in bonds and similar securities the amount of the return is fixed in the instrument, and therefore is known at the time of purchase, and depends on how much money the purchaser pays, for that determines the number of bonds he receives. In contrast, the amount of the monthly payment to beneficiaries is not fixed until the time of their retirement (that is, until the employee has completed the years of labor which the court below held to be his "purchase").<sup>31</sup> It depends on the employee's length of service with the employer, and the employer's judgment (made with the union in a collective bargaining context) of what level of payments is fair and necessary to provide some measure of financial security to the retiree. See *Alabama Power Co.*, 431 U.S. at 594. The actual return which any individual receives depends not only on the rate of payments but also on how long he lives in retirement. Further, bonds and debentures are ordinarily negotiable, and of course are expressly included within the statutory definitions of "security." Here again the court's analogy is without merit.

<sup>30</sup> Alef and Short, *Problems created by CA-7 decision that pension plan participation is a security*, 47 J. Tax. 282, 283 (1977). See also Note, *The Application of the Antifraud Provisions of the Securities Laws To Compulsory Noncontributory Pension Plans After Daniel v. International Brotherhood of Teamsters*, 64 Va. L. Rev. 305, 315 (1978).

<sup>31</sup> The rate of benefits may even be increased after retirement.

The court also rejected our contention that there is no *Howey-Forman* profit "because, on an amortized basis, some of the gain may be attributable to 'pooled' contributions of all participating employers, forfeitures of employees whose pension rights do not vest or to increased contributions negotiated by the union" (A. 226). But there is no "may be" about it. By far the greatest proportion of the difference between the contributions made with respect to an individual's employment (the hypothetical investment) and the ultimate benefit is due to the foregoing factors rather than investments. On this point the court below mistakenly attributes to us a concession which we did not make, and as to which the underlying facts are entirely different from what the Court of Appeals stated them to be. The Court of Appeals declared:

"A substantial part of the gain (which even defendants concede to be at least 25%) will derive from traditional return on the pension fund participant's investment, a dollar-profit element in the form of capital gains, interest, dividends, and other accumulated earnings realized from the trustees' management of the pension fund." (A. 227, citing IBT Br. 10-11.)

What was actually said in that brief, however (based on an affidavit of the Local 705 Pension Fund's actuary), was that:

"[A]n employee retiring in 1975 under the Local 705 Pension Plan had retirement benefits with a then current actuarial value of \$57,591, of which only \$14,542 was attributable to contributions to the fund resulting from his own employment and interest on those contributions (App. 184-8).<sup>[32]</sup> In other words, only one-fourth of the current value of his expected

<sup>32</sup> The citation is to the record in the court below, which is reproduced at A. 177 in this Court.

pension benefits was in any way traceable to his own employment, and the remaining three-fourths resulted from contributions made with respect to other employees covered by the plan". (IBT Br. 10-11).

Thus the 25% figure represents not what the Court of Appeals calls the "traditional return on the pension fund participant's investment," but the *total* of that "return" and the "investment". The underlying figures to which the International Union's brief referred show further that of the \$14,542 (or 25%), \$9,510 was the accumulated contributions paid on behalf of the employee and only the remainder, \$5,032, constituted the interest thereon. In reality, therefore, less than 9% of the entire benefit's actuarial value of \$57,951 constitutes the fund's investment gain on the employer contributions which the court characterized as plaintiff's "investment." It is on the basis of this 9% that the Court of Appeals determined that the Local 705 Pension Fund is an enterprise in which a covered employee realizes "profits from the efforts of others" (A. 226-228).

It is additionally significant, and probably differentiates defined benefit plans from anything which has ever been held to be a security, that in such a plan the level of benefits depends on the judgment of the employer (or trustees in a multi-employer plan) as to the long-run interests and requirements of the participants and the contributing employer(s) at any time. That judgment is in turn significantly influenced by the economic prospects of the employer (or the industry in a multi-employer fund). And since the relationship of contributions to benefits depends on actuarial considerations of which the assumed investment return is but one (see p. 11 *supra*), a better or worse investment performance may be offset by variances in the other factors which have also been assumed for actuarial purposes, such as mortality and turnover. Moreover, because most plans have

substantial unfunded but accrued liabilities, the net difference between assumptions and actuality in these plans will directly determine only the amount of the difference between assets and accrued liabilities. It will only indirectly affect the employer's contribution necessary to achieve a particular level of funding (as opposed to liability), and even less directly the level of pension benefits. This is not to say that investment performance cannot result in advantage to pension beneficiaries, but only that the relationship is far too attenuated to constitute a *Howey-Forman* profit. Cf. 421 U.S. at 855-857, rejecting the Second Circuit's view that the possibility that net income derived by the leasing by Co-op City for commercial activities, etc. would be used to reduce tenant rental costs was a "profit" to the tenant-stockholders.

b. For the foregoing reasons the investment appreciation of the employer's contributions to the fund bears too remote a relationship to the ultimate benefit to the employee to give rise to the kind of profit which has been a requisite of "investment contracts" under this Court's decisions. It is therefore perhaps superfluous to add that the court erred also in concluding that that which it held to be a profit was "from the efforts of others" in the *Howey-Forman* sense. But we shall discuss the point briefly because it again illustrates how the court's tendency to analogize led it astray.

The court observed "that gain relative to a security can derive from sources other than the direct efforts of the managers of the common enterprise" (A. 226). Neither the two pyramid scheme cases,<sup>33</sup> nor the variable

<sup>33</sup> *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473 (C.A. 5); *SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (C.A. 9), cert. denied, 414 U.S. 821.

annuity case,<sup>34</sup> nor the stock option case,<sup>35</sup> which the court cited (A. 226-227) support that proposition, let alone resemble this case sufficiently to warrant the court's reliance.

We are unable to determine from what, if anything, in the *VALIC* opinion the court below drew its assertion that "the payout to a maturing annuitant [in *VALIC*] was more likely to derive from investments of new annuitants than from a return on his original investment and the compounded income earned on it" (A. 226-227). In any event, that is not how the matter was viewed by this Court, which held the annuity contract to be "outside the concept of insurance" because the annuities "guarantee nothing to the annuitant except an interest in a portfolio of common stocks or other equities." (359 U.S. at 72). The fact that other individuals also bought the variable annuities may have been necessary for the continued profitability of the respondent company, but those other investments redounded solely to the profit of the respondent, and not to that of any annuitant. The very point of the pyramid cases was that the participation of the investors was relatively insignificant because, as the Fifth Circuit put it: "the critical determinant of the success of the Koscot Enterprise lies with the luring effect of the opportunity meetings", in which the promoters of the enterprise played by far the dominant role.<sup>36</sup>

<sup>34</sup> *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (*VALIC*).

<sup>35</sup> *Collins v. Rukin*, 342 F.Supp. 1282 (D. Mass.).

<sup>36</sup> 497 F.2d at 485. See also *Glenn W. Turner*, 474 F.2d 479-480, 482-483. These decisions declined to apply literally the third element of the *Howey* test that the profits of the enterprise be "solely from the efforts of others." 497 F.2d at 479-485; 474 F.2d at 480-483. We readily assume that these cases were rightly decided because we do not believe that the coverage of involuntary noncontributory pension plans under the securities laws turns on whether pyramid swindles are subject thereto. It is hardly surprising that the Courts

And, of course, the profit, if any, from possession of a stock option is due to the appreciation in the value of the underlying stock of a corporation, which in turn depends on the fortunes of that enterprise and thus on the efforts of its managers. That, presumably, is why "stock option" is expressly included in the statutory definitions of "security" so that the *Collins* case, which declined to exclude a particular transaction from that definition, says and decides nothing about the scope of the term "investment contract."

When these entirely different situations are put aside, and attention is paid to the realities of noncontributory defined benefit pension plans it is clear that the *entrepreneurial* efforts of those who are responsible for investing fund assets play a relatively minor role, if any, in determining the amount of the employee's pension benefits and that unless the "efforts of others" test is discarded completely, it must be concluded that there is no "investment contract" here. *Alabama Power* recognized that the efforts of the pension beneficiary himself play a major role in the amount of his benefit (see 431 U.S. at 594). To this must be added the efforts of the employer or trustees who determine the amounts of contributions and the employers who provide them, as well as the efforts of those employees who will never obtain a benefit.

#### B. There Is No "Purchase" or "Sale"

1. The determinations of the court below that a "purchase" and "sale" for purposes of the securities laws occur when an individual accepts employment covered by

of Appeals were unwilling to apply the *Howey* test restrictively at the behest of the promoters there, given the teaching of *Howey* itself that the definition of security "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." 328 U.S. at 299. See also, *Joiner*, 320 U.S. at 351.

an involuntary noncontributory pension plan and occur also when he continues in such employment are likewise contrary to the recent decisions of this Court, as well as the universal prior understanding of the securities laws.

In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, this Court admonished against imposing liability under § 10 (b) and Rule 10b-5 by "add[ing] a gloss to the operative language of the statute quite different from its commonly accepted meaning." *Id.* at 199.<sup>37</sup> This holding was expressly reaffirmed in *Santa Fe Industries v. Green*, 430 U.S. 462, 472, in reversing another expansive construction of these provisions. So here, it tortures the "commonly accepted meaning of the operative language of the statute" to say that an employee "purchases" his wages by performing labor; yet the Court of Appeals held that by performing labor an employee "purchases" an interest in a pension plan to which his employer contributes as partial compensation for that labor. The terms "purchase" and "sale" in § 10(b) of the 1934 Act and § 17(a) of the 1933 Act simply do not encompass every economic transaction in which an individual provides some kind of consideration for a return or for expectation of a possible return.

The Court of Appeals relied on these definitions of "purchase" and "sale" in the 1933 and 1934 Acts. Section 2(3) of the 1933 Act provides that: "[t]he term 'sale' or 'sell' shall include every contract of sale or disposition of a security or interest in a security, for value." Sections

<sup>37</sup> The court quoted with approval from *Addison v. Holly Hill Products*, 322 U.S. 607: "To let general words draw nourishment from their purpose is one thing. To draw on some unexpressed spirit outside the bounds of the normal meaning of words is quite another. . . . After all, legislation when not expressed in technical terms is addressed to the common run of men and is therefore to be understood according to the sense of the thing, as the ordinary man has a right to rely on ordinary words addressed to him." *Id.* at 617-618, quoted, 425 U.S. at 199, n.19.

3(a)(13) and 3(a)(14) of the 1933 Act provide respectively that "[t]he terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire" and "[t]he terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."

An employee's acceptance of or continuation in covered employment can be said to come within these statutory definitions only by once again misconceiving the economic reality of the transaction. The Court of Appeals said: "Here plaintiff acquired an interest in the Local 705 Pension Fund, and as shown, that interest is a security. Therefore, there necessarily has been a disposition of a security to plaintiff within the scope of the two Acts." (A. 242). See also A. 245 quoted at p. 55, *infra*. But as we have stressed, an employee acquires no "interest", let alone "interests" (*id.*) when he performs covered employment. See A. 64, p. 7, quoted at p. 12 *supra*. He merely builds up credits, which are nontransferable and are lost entirely if he voluntarily or involuntarily leaves covered employment or if the plan terminates before he achieves "vesting" under the plan's terms. See, *Alabama Power Co. v. Davis*, 431 U.S. 581, 594; *Malone v. White Motor Corp.*, No. 76-1184 (April 3, 1978), Slip Op. 4, 12. It is only at vesting that an employee obtains a right to receive a pension (immediately or in the future, if he has not then reached retirement age), or some lesser benefit as provided by the plan. If the employee quits his employment before vesting, and thereby loses the opportunity for a pension, is he "selling" an interest? Is the plan then "purchasing" that interest?

Thus, the court's view that there is a "purchase" and "sale" within the statutory definitions is based on a mistaken perception of the transaction. More fundamentally, even if the definitions somehow fit, it would still be

an incorrect interpretation of these laws to conclude that there is a "purchase" and "sale" when an employee accepts or continues in employment covered by an involuntary, noncontributory plan. For such decisions involve so many factors which are unrelated to the pension plan, let alone the investment characteristics which the court attributed to them, that such employment decisions cannot be assimilated to "investment decisions" which the terms "purchase" and "sale" connote and which the securities laws were designed to protect.

2. The court's finding of a purchase and sale here is inconsistent also with *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, where the Court relied heavily on "what may be described as policy considerations" (*id.* at 737, see also *id.* at 749) in holding that a cause of action did not lie. These policy considerations apply with at least equal force in the present case, especially when it is remembered that because the Local 705 pension plan was established after Daniel commenced the employment on which he bases his eligibility (see pp. 5, 11, *supra*), it is insufficient for Daniel's complaint to hold that acceptance of covered employment is a "purchase"; it is necessary to hold also that an employee "purchases" a "security" by continuing in covered employment. Yet, by thus continuing he no more changes his position than does a stockholder allegedly lulled into keeping his monetary investment, who is denied standing to sue under the *Blue Chip* rule.

The decision below thus equates the acceptance of employment with the purchase of stock, but then treats continuation in employment *more favorably* for the purposes of standing under the securities laws than a decision to hold the stock. This is truly a paradoxical result, given that the securities laws were "designed to safeguard the integrity of investment decisions." (*Robinson v. UMW*, *supra*, 435 F.Supp. at 247, emphasis added).

Moreover, it is true here, as it was in *Blue Chip*, that recognizing the cause of action would create the very "social cost[s]" identified in *Blue Chip*. (421 U.S. at 741). The holding that continuation in employment is a "purchase" "throw[s] open to the trier of fact many rather hazy issues of historical fact the proof of which depend[s] almost entirely on oral testimony." (*Id.* at 743)

This point is further developed, *id.* at 746, in reasoning which is also directly in point:

"[P]laintiff's entire testimony could be dependent upon uncorroborated oral evidence of many of the crucial elements of his claim, and still be sufficient to go to the jury. The jury would not even have the benefit of weighing the plaintiff's version against the defendant's version, since the elements to which the plaintiff would testify would be in many cases totally unknown and unknowable to the defendant. The very real risk in permitting those in respondent's position to sue under Rule 10b-5 is that the door will be open to recovery of substantial damages on the part of one who offers only his own testimony to prove that he ever consulted a prospectus of the issuer, that he paid any attention to it, or that the representations contained in it damaged him."<sup>38</sup>

Although acknowledging defendants' reliance on *Blue Chip* (A. 247, n.43) the court below did not address our showing that the reasoning of *Blue Chip* discredits the contention that there is a sale when an employee decides to keep a job which is covered by an involuntary non-contributory pension plan. But the parallel with *Blue Chip* is confirmed by the heavy weight which the Court of Appeals gave to Daniel's affidavit:

<sup>38</sup> If the phrase "plan booklets and other communications," were substituted for "prospectus of the issuer" in the foregoing passage, it would fit this case word for word.

"Also, plaintiff's affidavit shows that he would not have worked for a Local 705 covered employer if he had been advised about the continuous nature of the 20-year requirement before receiving a pension. When an employee decides to retain his job, his *decision* results in his continuing to give value in the future and in his further acquisition of interests in the pension fund." (A. 245) (emphasis added)

See also A. 246, n.41 and the section of the Court's statement of the case entitled "Plaintiff's Affidavit." (A. 213-217)

We have already pointed out the errors in the court's view that an employee acquires "interests in a pension fund" by working in covered employment, but its formulation is unsound in an additional respect which is of immediate significance. Whereas the Court posits a single "decision" by the employee that results in his continuing on a job for an indefinite future, in reality an employee "give[s] value" by working day after day and week after week in consequence of not one but innumerable decisions made for various reasons with various degrees of deliberation.<sup>39</sup> An employee's decision to remain at work one more day is at least as amorphous a predicate for a right of action under the federal securities laws as an investor's decision to hold his investment one more day rather than sell it and buy something else. Indeed, such decisions are more complex than that of an investor because isolating the pension benefit in the employment decision is wholly artificial. In determining whether to keep or quit his job, an employee considers a whole array of factors: these include, *inter alia*, his enjoyment of the job, the wages and fringe benefits of which the prospect

<sup>39</sup> One consequence of this oversimplification is that it avoids the difficult question of determining when the statute of limitations would begin to run with respect to any omission or misstatement which is alleged to violate the securities laws.

of a pension is but one, his perceived opportunities for advancement, and of course the job alternatives open to him. Thus, even if the employee believes that the pension plan is undesirable for him because he is uncertain whether he will qualify, or for any other reason, he is likely to remain on the job if his compensation (discounting the possibility of a pension entirely) and other satisfactions are greater than those which he believes he would receive at any other job open to him. See, *Los Angeles Dept. of Water & Power v. Manhart*, No. 76-1810 (April 25, 1978), slip. op. p. 13, n.30:

"\* \* \* the Department points to no 'adverse selection' by the affected employees, presumably because an employee who wants to leave the plans must also leave his job, and few workers will quit because one of their fringe benefits could theoretically be obtained at a marginally lower price on the open market. . . ."

In sum, whatever reasons an employee has for taking or continuing on a job do not explain why he continues to work there at some later date, and each such decision is as subjective as the decision not to purchase or sell in *Blue Chip*. It is as true here as in *Blue Chip* that such "an action under Rule 10b-5 will turn largely on which oral version of a series of occurrences the jury may decide to credit." (421 U.S. at 742). And "therefore no matter how improbable the allegations of the plaintiff, the case will be virtually impossible to dispose of prior to trial other than by settlement." (*Id.*).

It is also true here that "the mere existence of an unresolved lawsuit has settlement value to the plaintiff [and] not only because of the possibility that he may prevail on the merits \* \* \*" (*id.*) The reason, which differs from that in *Blue Chip*, but nonetheless represents a significant "social cost rather than a benefit" (*id.* at 741), is that the expense of defending against a 10b-5

or 17(a) claim would invariably be greater than paying a pension to a claimant even if he is ineligible under the pension plan's rules. Plan trustees will thus be put to the truly unenviable choice of spending the fund's assets to defend a lawsuit, or disregarding the plan's eligibility requirements. Under either choice, the individuals who do qualify under the plan's rules would be the ultimate losers, because less money would be available to pay their benefits. That these concerns are not chimerical is evidenced by the present suit, and particularly its ambitious class action allegations. (see p. 2, *supra*).<sup>40</sup>

3. Prior to the decision below no court or agency had ever held that there is a "purchase and sale" under the securities laws when an individual accepts or remains in employment covered by an involuntary, noncontributory pension plan. Even the District Court found the "purchase and sale" in plaintiff's participation in union contract ratification rather than in his taking and keeping his job.<sup>41</sup> (A. 127-128). That court correctly stated:

"[E]xcept in those cases where recognized securities were offered by an employer for voluntary purchase

<sup>40</sup> A further policy consideration mitigating against allowing this new cause of action, and which we urge in point III as independently decisive, is that the Congress has already determined which judicial and administrative remedies are to be available to pension plan participants.

<sup>41</sup> It is unclear whether the court below accepted the District Court's view as an alternative ground for decision. Compare, A. 229, 242-247 with A. 254-255. In any event, that theory is without merit, for the reasons discussed in the brief of Local 705, which we shall not reiterate. Two points bear emphasis, however: (1) Ratification does not come within either the natural meaning of the statutory definition of the terms "purchase" and "sale." (2) The relationship between union members and their union, when it is acting as collective bargaining representative, is utterly remote from the scope of the securities laws; it would be incongruous to seize upon ratification, which is generally regarded as a democratic and desirable practice, as the predicate for imposing securities laws liability.

by employees, the SEC acted on the assumption, consistent with existing legal thought, that employee pension plans were generally 'non-contributory' and 'involuntary', and therefore resulted in no sale and no nexus to the securities laws." (A. 115)

Judge Tone, stated in his concurring opinion:

"In reaching this conclusion, [that the securities laws apply] I have found little comfort in the opinion expressed by the SEC, as *amicus curiae*. Apparently for the first time ever, it now takes the position in its brief before us that the employee's interest or expectancy in a plan such as this is subject to the anti-fraud provisions of the securities laws." (A. 260)

He pointed to the SEC's 1971 Institutional Investor Study<sup>42</sup> wherein "the Commission's view was that although a noncontributory pension plan might well be an investment contract, the element of sale was lacking." (A. 260-261, citing 3 SEC Study 996). The majority below, however, accepted the assertion in the SEC's brief that the agency's prior "no-sale" rationale was limited to the registration provisions of the securities laws and did not apply to its anti-fraud provisions. (A. 245-246). An examination of the SEC Study shows that Judge Tone was clearly right.

In a portion of the Study entitled "Legal, Regulatory and Tax Environment of Pension-Benefit Plans and Public Retirement Systems",<sup>43</sup> subpart 7, "The Securities Laws", "discuss[es] the manner in which the federal securities laws applied to pension-benefit plans in the years leading up to and during the period covered by

<sup>42</sup> Institutional Investor Study Report of the Securities And Exchange Commission, House Document No. 92-64, 92nd Cong., 1st Sess. (1971) (the "SEC Study").

<sup>43</sup> SEC Institutional Investor Study, 980. This portion is part of Chapter VIII, "Pension-Benefit Plans, Foundations and Education Endowments."

this Study."<sup>44</sup> Under the heading "a. The Securities Act of 1933", the following appears:

"(1) *Corporate pension and profit-sharing plans—*  
(a) *Plans not providing for voluntary contributions.*—In the case of plans which are unfunded (pay-as-you-go basis plans) and in the case of plans where contributions to the funding medium consist of either employer money only or employee contributions which are required as a condition of employment, the Commission staff has taken the position *that the Securities Act does not apply* because there is no 'sale' or 'offer for sale' of a security. Although the employees' interests in the plan (whether the plan's assets are invested through a funding medium or consist solely of an obligation of the employer recoverable from the general assets of the employer) may be recognized to be 'securities' within the Act, the absence of a volitional element on the part of the employees in acquiring these interests is the basis for the position. While this result may not be compelled by the statutory definition of 'sale,' the result is consistent with the basic scheme of the Act to provide would-be purchasers with information adequate to make an informed opinion as to whether to purchase—assuming that there is a real difference between employer and employee contributions.

"(b) *Plans providing for voluntary employee contributions.*—In the situation where the employee may make voluntary contributions to the plan (or in the case of certain savings plans) the absence-of-volition rationale cannot come into play. However, the Commission staff has in the past taken a no-action position 'that no question will be raised with respect to

<sup>44</sup> *Id.* at 995 omitting a footnote which states that "[t]he Securities Act of 1933 [citation] and the Investment Company Act of 1940 [citation] are the acts of principal concern in the context of this chapter." There is some discussion of the Investment Company Amendments Act of 1970, but none of the 1934 Act.

the registration of participations in a voluntary contributory pension, profit-sharing, or similar plan that does not invest in the securities of the employer company in an amount exceeding the company's contribution.' If the plan exceeds this amount in investments in company securities, both the company stock and the interests in the plan must be registered under the Securities Act."<sup>45</sup>

Thus, the Commission's "no-sale" interpretation of the statute applied to all noncontributory plans and all involuntary pension plans and excluded them from its registration and anti-fraud provisions.<sup>46</sup> The Commission also had an *administrative practice* with respect to voluntary contributory plans, whereby it would take "no action" if certain types of voluntary contributory plans (that is those wherein employee payments were not used to purchase the employer's stock) were not registered. The view of the majority below that the Commission's historic no-sale position had been limited to registration is untenable. In fact, the commission *never* exercised the authority which it first asserted on brief in the court below; it *never* regulated noncontributory involuntary pension plans under the anti-fraud provisions of the 1933 and 1934 Acts, either by rules, or interpretive guidelines, or enforcement proceedings. (See 1933 Act §§ 19 (a), 20, 24; 1934 Act §§ 21, 23(a)(1)) "Failure to use such an important power for so long a time indicates to us that the Commission did not believe the power existed." *Federal Power Commission v. Panhandle E. P. L. Co.*, 337 U.S. 498, 513. See also *United States v. Enmons*, 410 U.S. 396, 408-410. Of this the court below said nothing.

Because the court below erroneously believed that the SEC's "no sale" interpretation was limited to registration it failed to appreciate that the present case represents a drastic change in the SEC's position and gave

<sup>45</sup> *Id.* at 996-997 (emphasis added, footnotes omitted.)

<sup>46</sup> See also A. 261 (concurring opinion).

the Commission's present views far greater weight than they deserve under the circumstances (See *e.g.*, *Forman*, 421 U.S. 837, 858, n.25, followed in *General Electric Co. v. Gilbert*, 429 U.S. 125, 143; *Piper v. Chris-Craft Industries*, 430 U.S. 1, 41, n.27) and no weight whatever to the position which the SEC took in the first forty years. See also *Hochfelder*, 425 U.S. at 212-214. Moreover, the SEC's prior position that there is no sale "gave a sounder construction to [the securities laws] than the [Commission's] construction in the present case." Cf. *Labor Board v. Drivers Local Union*, 362 U.S. 274, 291.

As the court below observed, the SEC had first "reasoned that there was no sale involved for a noncontributory plan because there was no direct investment of money by the employee, consistent with the then current legal view that the employer's contributions were gifts." (A. 245)

In the court's view this reasoning was unsound because noncontributory pensions are now regarded as compensation for an employee's labor. But the fact that it is now generally recognized that a participation in a pension plan is not a gratuity granted by the employer does not undermine the Commission's original interpretation of the securities laws which were enacted when pensions were generally regarded to be gifts.

"In interpreting the statute it is not our task to consider whether Congress was mistaken" in 1933 and 1934 in its view of the nature of a noncontributory involuntary pension plan; "rather, we must construe the statute in light of the impressions under which Congress did in fact act. . . ." *Moor v. County of Alameda*, 411 U.S. 693, 709; see also *Brown v. GSA*, 425 U.S. 820, 828; *Califano v. Sanders*, 430 U.S. 99, 107, n.7. It is especially unfitting for the courts to attribute the present, more sophisticated appreciation of the nature of these pension plans to the 73rd Congress because when later Congresses also rejected the "gift" theory, they concluded not that the se-

curities laws should govern, but that special pension legislation was necessary. See point III A, *infra*.

The point was well made by Sen. Javits in commenting on ERISA:

"\* \* \* I believe that the law [ERISA] has settled in an indisputable fashion, the legal status of private pensions. Whatever lingering doubts may have persisted prior to its passage, the law tells us that private pensions are a form of deferred wages and not a form of gratuity to be offered and withdrawn at the whim of the employer. In short, the 'gold watch' theory of pensions is dead once and for all, and we have entered into an era where pension rights and duties are defined under the law and subject to systematic interpretation and enforcement under the law."<sup>47</sup>

But in 1934 Congress' "policy ha[d] not yet moved to this point."<sup>48</sup> Therefore, the "gift" theory is an entirely sound interpretation of the securities laws as enacted by the Congress and should not have been abandoned by the SEC.

Moreover, the view expressed by the SEC in the Study, that there is no sale when an employee is covered by a compulsory noncontributory plan because he makes no "choice", is also correct. The court below, however, rejected this analysis. It stated that "the definitions of 'sale' in the 1933 and 1934 Acts do not require volition." (A. 244). Because this statement was not further explained, it is not clear whether the court was thereby accepting the argument (made by the plaintiff but not the SEC) that volition is never an element of a purchase or sale. Plainly, its omission in the definitions

<sup>47</sup> Address by Senator Jacob K. Javits, Briefing Conference on Pensions and Employee Benefits, September 19, 1974, p. 1.

<sup>48</sup> Cf. *Labor Board v. Insurance Agents*, 361 U.S. 477, 500.

of "purchase" and "sale" cannot be controlling. *Forman* makes quite clear that even if a transaction is literally within the statutory definition of the operating terms, the securities laws do not apply if the result is outside the statutory purpose. (See 421 U.S. at 848-851).<sup>49</sup> The purpose of the prohibitions against material misstatements or omissions is to provide the investor with information to make an *investment decision*, and where there is no choice and therefore no *decision* to be made these prohibitions simply do not come into play. (See 3 SEC Study 996-997).

In determining that there is no "volition" requirement for a "purchase" and "sale", the court below analogized an employee's voting to ratify a collective agreement which provides for employer contributions to a pension plan to a stockholder's vote to approve a corporate merger. (A. 244-245). But the authoritative rulings involving such stockholder votes do not dispense with the requirement of volition, and the proffered analogy is entirely without merit.

This Court held in *SEC v. National Securities*, 393 U.S. 453, that a purchase and sale are present for purposes of § 10(b) and Rule 10b-5 in certain types of corporate merger situations. The Court's description of the facts demonstrated that the shareholder's vote in that legal context *did* involve an investment choice by the individual voting shareholder:

"According to the amended complaint, Producers' shareholders were misled in various material respects

<sup>49</sup> See also *Lino v. City Investing Co.*, 487 F.2d 689, 694 (C.A. 3):

"[I]t is our view that the legislation was not intended to cover the transaction which occurred here. All of the definitional sections involved in this case are introduced by the phrase 'unless the context otherwise requires.' The commercial context of this case requires a holding that the transaction did not involve a 'purchase' of securities." (Emphasis in original.)

prior to their approval of a merger. The deception furthered a scheme which resulted in their losing their status as shareholders in Producers and becoming shareholders in a new company. Moreover, by voting in favor of the merger, each approving shareholder individually lost any right under Arizona law to obtain an appraisal of his stock and payment for it in cash. Ariz.Rev.Stat.Ann. § 10-347 (1956). Whatever the terms 'purchase' and 'sale' may mean in other contexts, here an alleged deception has affected individual shareholders' decisions in a way not at all unlike that involved in a typical cash sale or share exchange. The broad antifraud purposes of the statute and the rule would clearly be furthered by their application to this type of situation. Therefore we conclude that Producers' shareholders 'purchased' shares in the new company by exchanging them for their old stock." (393 U.S. at 467).

The court below relied on the SEC's rescission, by Rule 145, 17 C.F.R. § 230.145, of its prior Rule 133 (that in certain situations involving statutory merger and other types of corporate reorganizations no "sale" or "offer" should be deemed to be involved for purposes of the registration requirements of the 1933 Act.) (See 393 U.S. at 465). But the SEC's change was not premised on an interpretation of the statutory term which eliminates the volitional element. On the contrary, the SEC explained that it was making the change because, contrary to the assumption underlying Rule 133, volition is present:

"Transactions of the character described in Rule 133 do not in the Commission's opinion occur solely by operation of law and without the element of individual stockholder volition. A stockholder faced with a Rule 133 proposal must decide on his own volition whether or not the proposal is one in his own best interest." <sup>50</sup>

<sup>50</sup> Securities Act Release No. 5246, CCH Federal Securities Law Rep., 1971-1972 Dec. ¶ 78,753, p. 81,567.

The SEC's explanation of Rule 145 also shows why the analogy proffered by the court below between a shareholder's vote on a corporate merger and the ratification of a contract proposal which contains provisions for contributions to a pension plan is legally unsound. The Commission said:

"In voting, each consenting stockholder is expressing his voluntary and individual acceptance of the new security, and generally the disapproving stockholder is deferring his decision as to whether to accept the new security or, if he exercises his dissenter's rights, a cash payment. The corporate action *in these circumstances*, therefore, is not some type of independent fiat but is only the aggregate effect of the voluntary decisions made by the individual stockholders *to accept or reject the exchange.*" <sup>51</sup>

This, of course, is the same point made in *National Securities* concerning the shareholder's loss of his appraisal rights under Arizona law if he voted for the merger. But there is no equivalent of this critical factor in the member ratification vote. Although a dissenting stockholder can opt out of a merger by asserting his appraisal rights, under the law which governs the relationship between employees, employers and a union bargaining representative, the employee cannot, by his individual vote (or otherwise), opt out of a particular provision in a collective bargaining agreement. On the contrary, § 9(a) of the National Labor Relations Act gives the representative the exclusive authority to bargain about terms and conditions of employment, and to bind consenting and nonconsenting members of the unit. This authority gives rise to, and is limited only by, the duty of fair representation, which plaintiff has indeed invoked in Count III of his complaint. (A. 38-42). See, e.g., *Hines*

<sup>51</sup> *Id.*, (emphasis added to show the court's elisions in the sentence from which it quoted at A. 245.)

*v. Anchor Motor Freight Lines*, 424 U.S. 554, 564; *Emporium Capwell Co. v. Western Addition Comm. Org.*, 420 U.S. 50, 65; *NLRB v. Allis-Chalmers Mfg. Co.*, 388 U.S. 175, 180. The member's right to vote on ratification, which he enjoys—if at all—only by virtue of his union's constitution or bylaws rather than state or federal law, is the mechanism by which the union determines whether to accept a proposed collective bargaining agreement. That vote is on the contract proposal in its entirety.<sup>52</sup> If a majority votes to accept, that becomes the decision of the representative, and the contract by which all employees in the unit are bound.

The foregoing examination of the court's attempt to equate a union member's vote on a collective bargaining agreement with a shareholder's vote on corporate mergers not only undermines its conclusion that a "purchase" and "sale" are present herein; it again illustrates that even where certain resemblances can be found it is a hazardous undertaking to import securities law concepts into a labor relations context.

The court determined that volition was present aside from the ratification vote because plaintiff Daniel testified that he would not have continued in his job for a covered employer if he had known about the eligibility requirement by which he was ultimately disqualified. (A. 245, quoted at p. 55 *supra*). But this ground for

<sup>52</sup> Here, too, the elements of the individual member's decision are complex. He may vote to ratify a proposed contract even if he disapproves of its provisions with regard to pensions if he believes that no improvement would result from further negotiations, or because the contract as a whole is more desirable than any which could result if this contract were rejected, or because he does not want to go on strike where that is the alternative to acceptance of the employer's offer. On the other hand, an employee may vote against ratification even if he is satisfied with its pension provisions if he believes that some other term, for example the basic wage, or provisions for overtime are insufficient and he believes that a strike or the threat thereof will achieve a better contract.

decision reads "purchase" and "sale" too loosely (see pp. 51-53, *supra*), and gives rise to the same "social costs" (421 U.S. at 741) which this Court has held should be avoided in delineating the contours of the judicially created cause of action under Rule 10b-5 (see pp. 54-57 *supra*).

Moreover, this Court has repeatedly "recognized that a private cause of action under the antifraud provisions of the Securities Exchange Act should not be implied where it is 'unnecessary to ensure the fulfillment of Congress' purposes in adopting the Act." *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 477, quoting *Piper v. Chris-Craft Industries*, 430 U.S. 1, 41; See also *Forman*, 421 U.S. at 859-860; *Blue Chip*, 421 U.S. at 736-737, 749. Allowing this case to be brought under the securities laws would be entirely foreign to their purpose.

### III. THE DECISION BELOW IS CONTRARY TO THE PRIOR UNDERSTANDING OF THE SECURITIES LAWS, WHICH CONGRESS SHARED IN ENACTING SPECIFIC LEGISLATION CONCERNING DISCLOSURE BY PENSION PLANS TO EMPLOYEES.

#### A. The Decision Below Subverts the Judgments Made by Congress in Enacting the WPPDA and ERISA in Reliance on the SEC's Representations.

Congress has twice enacted legislation designed to protect the interests of participants and beneficiaries in noncontributory involuntary plans, and dealt therein with the precise problem of the nature and timing of disclosure to which plan participants and beneficiaries are entitled. Congress did so in 1958 in the Welfare and Pension Plan Disclosure Act (WPPDA), and in 1974 more comprehensively through the Employment Retirement Income Security Act (ERISA). On both occasions the SEC disclaimed either authority or expertise concerning collectively bargained pension plans, and it reinforced the Congressional understandings—first (prior to

WPPDA), that employees were not at all protected by federal law with respect to information concerning pension benefits, and thereafter (prior to ERISA), that existing law was inadequate, in part because no law provided employees with sufficient information. At no time were the Congressional committees studying pension plans advised that the securities laws (specifically § 17(a) of the 1933 Act and § 10(b) of the 1934 Act) already obligated plan administrators or others to provide employees who obtain or choose to retain employment covered by a collectively bargained pension plan with information concerning that plan, or that those laws dealt in any manner with the relationship between such pension plans and their participants. The committees were told just the opposite. And in both instances they legislated in light of their clearly expressed belief that the federal securities laws are inapplicable to that relationship.

**1. *The Welfare and Pension Plans Disclosure Act of 1958 (WPPDA).***

The purpose and scope of the WPPDA have so recently been canvassed by this Court in *Malone v. White Motor Corp.*, — U.S. —, No. 76-1184 (April 3, 1978), that elaboration here is unnecessary. Briefly, it was, as its very name reveals a "Disclosure Act". The aim of the bill was "to make available to the employee-beneficiaries information which will permit them to determine, first, whether the program is being administered efficiently and equitably; and, second, more importantly, whether or not the assets and prospective income of the programs are sufficient to guarantee the benefits which have been promised to them." (*Malone*, slip op. p. 14, quoting Senator Smith). (See also *id.* at 8, 10-11, 13.) Our particular concern here is with the role of the SEC in the process which resulted in the enactment of the WPPDA and with the Congressional understanding—to which the

SEC significantly contributed—that in creating these disclosure obligations it was filling a legislative vacuum in "the nearly unregulated pension field" (*id.* at 8).

As noted in *Malone*, Congressional consideration of the problems in the pension field began in 1954 after a message by President Eisenhower. (Slip op. p. 8.) In 1955 testimony was given on behalf of the SEC to a Subcommittee of the Senate Committee on Labor and Public Welfare conducting a welfare and pension plans investigation. Among those testifying on behalf of the SEC were a member of the Commission and the Director and Counsel of the Division of Corporate Finance. They testified that the statutes administered by the SEC did not include disclosure provisions relating to pension plans as such and that the very few pension plans which had registered under the Securities Act involved the sale of securities by a company to its employees. SEC Commissioner Goodwin agreed with Senator Allott that "the Securities and Exchange Commission would come into this particular field only by accident, so to speak, by virtue of the fact that, for example, in some of these plans stock is offered."<sup>53</sup>

The SEC representatives were among several witnesses from various federal agencies who testified "as to the extent of any supervision these agencies exercised over employee welfare and pension plans under existing Federal laws". Welfare and Pension Plans Investigation, S. Rep. 1734, 84th Cong., 2d Sess., p. 4 (1956) (The "1956 Report").

Chapter 3 of the Subcommittee's report was devoted to a discussion of the inadequacies of existing federal and

<sup>53</sup> Welfare and Pension Plans Investigation, Hearings Before the Subcommittee on Welfare and Pension Funds of the Committee on Labor and Public Welfare, U.S. Senate, 84th Cong., 1st Sess. (1955) pp. 943-946.

state laws. Surveying existing federal control of welfare and pension funds, the 1956 Report stated:

"In brief, there are two Federal statutes which have some application to welfare and pension plans. They are the Labor Management Relations Act of 1947 (29 U.S.C. § 186 (sec. 302)) and the Internal Revenue Code of 1954." (*Id.* at p. 57.)

After reviewing the shortcomings of the two statutes cited, the 1956 Report concluded:

"Thus, with the exception of the ineffective sections of the Labor Management Relations Act, 1947, and the Internal Revenue Code, as discussed above, there presently exists no Federal statute, regulation, or authority which attempts to protect the rights of the beneficiaries of welfare and pension plans." (*Id.* at p. 60.)

The SEC made an even more significant contribution to the legislative process in the 84th Congress, which enacted the WPPDA. First, the Commission filed a written report and memorandum on the proposed pension and welfare plan legislation in which, *inter alia*, it compared the two major bills (that of Sen. Douglas, S. 1122, and that of Sen. Ives, S. 1145).<sup>54</sup> The report also made detailed comments on the Douglas bill under which administrative responsibility was vested in the SEC; it made no recommendations with respect to the Ives bill because it was to be administered by the Secretary of Labor.<sup>55</sup> Although it observed that "[b]oth bills provide for disclosure to beneficiaries and to the public,"<sup>56</sup> the SEC's

<sup>54</sup> The report is reprinted in its entirety at pp. 62 *et seq.* of the Hearings Before the Subcommittee on Welfare and Pension Plans Legislation of the Senate Committee on Labor and Public Welfare, 85th Cong., 1st Sess. ("1957 Hearings"). S. 1122 appears *id.* at 2-8; S. 1145 appears *id.* at 8-11.

<sup>55</sup> *Id.* at 64.

<sup>56</sup> *Id.* at 63.

Report gave no hint that the SEC believed that any such disclosure was already required by the securities laws.

Thereafter, the SEC's Acting Chairman, Mr. Orrick, appeared at a hearing of the Senate Subcommittee and testified that "[t]he functions of the Securities and Exchange Commission are devoted to the regulation of the capital securities markets . . . But the area covered by a bill on welfare and pension funds does not, as such, deal with the capital-securities markets." (*Id.* at 107). It is as though Congressman Wolverton were speaking! (See p. 111, *infra.*) Mr. Orrick's view was reaffirmed in a subsequent memorandum submitted by the Commission:

"Many of the plans involved in this legislation are the fruits of collective bargaining. Accordingly, these plans are inseparably intertwined with labor-management relations. Abuses in this area then have their main effect upon an economic area in which the Commission does not possess expertise.

"It is true that the Commission and its staff have developed an expertness in financial analysis of corporate securities and full disclosure of financial information. Inasmuch as welfare and pension plan beneficiaries generally have no individual choice as to the securities to be purchased by a welfare or pension fund, the type of meaningful information to be furnished to them as to the management, investments and transactions of their funds may involve quite different criteria from those presently employed by the Commission under the various Federal Securities Acts. An agency which has had close contact with the needs and problems in the labor-management field would be in a better position to determine the appropriate criteria."<sup>57</sup>

Against this background, Congress determined to regulate welfare and pension plans and to vest administrative

<sup>57</sup> *Id.* at 119.

responsibility in the Department of Labor rather than the SEC.

The 1958 Senate Report explained:

"Serious consideration was given earlier to placing the administration of the bill with the Securities and Exchange Commission on the basis of its past experience in the administration of disclosure type legislation. However, as the official representatives of the Securities and Exchange Commission clearly indicated that they did not feel they were the proper agency to handle the administration of this type of legislation and as they felt that the taking on of this function might interfere with their presently established functions, this consideration was abandoned."<sup>58</sup>

## 2. Employment Retirement Income Security Act of 1974 (ERISA).

In ERISA Congress substantially expanded the disclosure requirements which had been embodied in the WPPDA, and, for the first time, subjected pension plans to broad federal substantive regulation. See *Malone*, slip op. p. 14. It did so, in light of the understanding that "there are essentially three federal statutes which, although accomplishing different purposes and vested within different federal departments for enforcement, are all compatible in their regulatory responsibilities"—the WPPDA of 1958, the Labor-Management Relations Act of 1947, and the Internal Revenue Code.<sup>59</sup>

At the outset of its investigation the Senate Subcommittee had caused a detailed analysis to be made of all legislative regulation of pension plans, the results of which were set forth in the 1971 Interim Report<sup>60</sup> and

<sup>58</sup> S.Rep. No. 1440, 85th Cong., 2d Sess. (1958), p. 21.

<sup>59</sup> See Interim Report cited at n. 60, *infra*, and summaries cited at p. 73, n. 61 *infra*.

<sup>60</sup> Interim Report of Activities of the Private Welfare and Pension Plan Study, S. Rep. No. 92-634, 92d Cong., 2d Sess. (1972).

were then carried forward in subsequent committee reports in both bodies, in a summary entitled "*The Existing Law*".<sup>61</sup> The majority opinion interpreted the Report's discussion of the role of the securities laws as stating only that the *registration* requirements of the 1933 Act were deemed to be inapplicable, and not that there is no securities laws coverage (A. 251-252). It described the failure to make this distinction as "defendants' quintessential error" (A. 252), but it is plainly the majority below which erred. For, the Interim Report stated that "pension and profit-sharing plans are exempt from *coverage* under the Securities Act of 1933 \* \* \* unless the plan is a voluntary contributory pension plan and invests in the securities of the employer company an amount greater than that paid into the plan by the employer."<sup>62</sup>

The foregoing appears in a portion of the report which describes the peripheral role of the SEC in a chapter which details the administrative responsibilities of all federal agencies (nine in number) which had any relationship to private pension plans; the discussion of the SEC is set out in full in the margin.<sup>63</sup> At the outset of that

<sup>61</sup> S. Rep. No. 93-127, 93rd Cong., 1st Sess., 4-5 (1973), I ERISA Leg. Hist. 587, 590-591; H.R. Rep. No. 93-533, 93rd Cong., 1st Sess., 3-5 (1973), II ERISA Leg. Hist. 2348, 2350-2352.

<sup>62</sup> Interim Report at 96 (our emphasis). The fact that the Report also observed that those plans which are covered must be "*registered*" (court's emphasis) cannot narrow the word "*coverage*" to encompass only the registration requirements.

<sup>63</sup> "Although the Securities and Exchange Commission (SEC) does not have direct regulatory authority over private pension plans, certain provisions of the federal securities laws which it administers do apply to such plans. These provisions relate primarily to registration of securities and to annual and other periodic reports required to be filed with SEC.

"Pension and profit-sharing plans are exempt from coverage under the Securities Act of 1933 (15 U.S.C. 77 *et seq.*), unless the plan is a voluntary contributory pension plan and invests in the securities of the employer company an amount greater than that paid into the

chapter the report stated that only the Labor Department and the Treasury Department (through the Internal Revenue Service) were considered to have "any degree of control" over the administration and operation of private pensions.<sup>64</sup> The Court of Appeals' reading of the Interim Report also cannot be squared with the section "Legislative Regulation," which does not even mention the securities laws.<sup>65</sup>

plan by the employer. A voluntary contributory plan is one to which both the employee and employer contribute and in which employees voluntarily participate. If the plan's investment in the employer's securities exceeds the employer's contribution, both the employer's securities and the interests in the plan must be registered under the Securities Act with SEC.

"Where interests in a private pension plan are registered under the Securities Act, as indicated above, the administrator of the plan must file annual and other periodic reports with SEC pursuant to the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)), unless the plan covers fewer than 300 persons.

"Although private pension plans generally fall under the definition of investment companies under the Investment Company Act of 1940 (15 U.S.C. 80a-3(a)) which subjects such companies to SEC regulation, sections 3(c)(3) and 3(c)(11) of the act generally exempt pension plans from the act's provisions.

"Since 1955 SEC has been collecting statistical data with respect to pension funds. Since most pension plans are exempt from coverage under the securities laws, these data are gathered voluntarily under the general statistical program of the Government.

"These data are published as follows:

1. Assets of private pension funds not administered by insurance companies are published quarterly in SEC's Statistical Bulletin.
2. Stock activity of pension funds is summarized quarterly in SEC's releases entitled "Stock Transactions of Financial Institutions."
3. A survey of pension funds' mortgage-lending activities and commitments is conducted by SEC and the results are published monthly by the Department of Housing and Urban Development." (Interim Report at 96-97)

<sup>64</sup> *Id.* at 91.

<sup>65</sup> *Id.* at 23-29.

As when the 1958 Act was being considered, the representatives of the SEC urged the enactment of pension legislation and again gave no hint that the relationship between pension plans and their participants was already subject to the securities laws.

In 1965, the President's Committee on Corporate Pension Funds had filed a unanimous report, joined by the Chairman of the SEC, Mr. Manuel F. Cohen, which recommended legislation for increased disclosure to, and remedies for, pension plan beneficiaries. The President's Committee recommended "a requirement for the disclosure of additional information related to the investment activities of retirement plans, by amendment of the Welfare and Pension Plans Disclosure Act. Disclosure of investment holdings and activities in much more detail than is now required, *perhaps in the same manner as is required of investment companies under S.E.C. regulation*, would seem useful and entirely feasible without impairment of retirement plan operations."<sup>66</sup>

And in 1972, when the lengthy legislative process was underway, the then SEC Chairman, Mr. William J. Casey stated in a letter to the Subcommittee which was responsible for what became ERISA:

"[W]e believe that employee benefit plans *should be* subject to the requirement of adequate disclosure of investment returns based upon appropriate adjustment for volatility. In this way, the participants, as well as the Secretary of Labor, would be advised of the extent to which the plan's investment assets were being subjected to varying degrees of investment risk."<sup>67</sup>

<sup>66</sup> President's Committee on Corporate Pension Funds, *etc.*, *Public Policy and Private Pension Programs—A Report To The President on Private Employee Retirement Plans* (1965), p. 78.

<sup>67</sup> S. Rep. No. 92-1150, 92d Cong., 2d Sess. 68 (Emphasis added.)

The majority below relied on the testimony of Mr. Cohen in the 1972 Senate Hearings. But Mr. Cohen's testimony confirmed the conclusion of the Interim Report regarding the limited role of the SEC, which he read and endorsed:

"Let me address myself to the more urgent problems. The first is fragmentary regulation. As the studies so diligently undertaken by this subcommittee have so convincingly demonstrated, the Federal authority and responsibility now dispersed among *nine different Federal agencies*, under at least as many different statutes, must be pulled together and coordinated. The obvious place for most of the Federal authority and responsibility is in the Labor Department under the auspices of the Secretary of Labor."<sup>68</sup>

And he strongly reiterated the view that Congress should enact pension reform legislation. His recommendations and those of his successor would have been pointless if Messrs. Cohen and Casey had believed that the 1933 and 1934 securities laws already required disclosures from involuntary noncontributory pension plans to their participants.

The majority below notes also that "the Congress that enacted ERISA" was not "unaware that the SEC considered interests in pension funds to be securities under the 1933 Act unless excepted" (A. 253, n.53), referring to the 1971 Institutional Investor Study. But, as Judge Tone recognized (A. 260-261), Congress' awareness of the SEC Study cuts *against* the conclusion that Congress

<sup>68</sup> Hearings on S. 3598 before the Subcommittee on Labor of the Senate Committee on Labor and Public Welfare, 92d Cong., 2d Sess. 232 (1972). (Emphasis added.) Compare pp. 73-74, *supra*. It is somewhat ironic that that testimony should be cited in support of an interpretation of the securities laws which would further fragment regulatory authority and impose an additional statutory scheme on private pension plans.

believed the antifraud provisions to be applicable and only the registration provisions to be inapplicable. For the SEC Study also declared that "the Commission Staff has taken the position that the Securities Act *does not apply* because there is no 'sale' or 'offer for sale' of a security." SEC Study, p. 996, emphasis added. See p. 59, *supra*.

In sum, Judge Tone was clearly right when he stated: "Members of Congress considering legislative proposals after the adoption of the securities acts who relied on the SEC's interpretation of those acts must have understood that they did not apply to transactions of the kind before us." (A. 261, concurring opinion). He declined to give controlling weight to that fact, however, because he attributed to Congress the understanding that the question was open in "the Supreme Court [which] has been known to disagree with" the SEC, and that it "appears likely that Congress has chosen to leave the matter in that posture." (*Id.*) But we submit that however plausible such a hypothesis may be in other legislative contexts, there is abundant evidence that it does not accurately describe the intentions of the Congress that enacted ERISA. The legislative record presents no basis whatsoever which would justify the surmise that Congress even contemplated the possibility that the securities laws might apply to the relationship between involuntary noncontributory pension plans and their participants. On the contrary, its description of "the existing law" in the final reports issued by the respective committees of the House and Senate (see p. 73, n.61, *supra*) evidences that Congress was confident that it was entering an area in which there were no existing federal laws, except for the Internal Revenue Code and WPPDA, which were substantially superseded by ERISA, and the LMRA which simply prescribes the structure of certain types of collectively bargained plans. Moreover, if Congress had been given any reason to entertain a doubt on this score, it most probably would have taken steps to prevent the securities

laws from expanding into this area, for the avoidance of bureaucratic duplication and conflict was one of Congress' principal objectives.<sup>69</sup>

### 3. *The Upshot.*

The court below said "that the SEC has historically *advocated* a hands-off approach to the regulation of pension plans with respect to disclosure requirements holds no brief for exempting pension plans from the anti-fraud provisions of the securities acts." (A. 252-253, *emphasis added*). But the statements of the SEC cannot accurately be so described. The SEC did not favor a general "hands-off" policy; on the contrary, as we have seen, in 1972 its Chairman affirmatively recommended that legislation governing disclosure by pension plans to their participants be enacted; and in 1957 what it advocated was that jurisdiction over such regulation be vested in an agency with greater competence over the subject than the Commission, not that no such legislation should be enacted. More significantly, the Commission's observations were not mere "advocacy" but rather were disclaimers of authority under the then-existing state of the law, which in the context of the proposals before Congress on those occasions could only have been understood as assertions that no legislation for which it was then responsible

<sup>69</sup> See, *e.g.*, ERISA § 3004 set forth at 10a-11a, *infra*. See also, *e.g.*, Senator Williams' explanation of the bill which was enacted:

"One of the thornier problems confronted by the conferees was the question of arranging a workable administrative and enforcement structure that would incorporate the historic role of the Internal Revenue Service with respect to qualified plans as well as the broader role visualized for the Labor Department in terms of safeguarding the interests of participants and beneficiaries and applying its expertise in connection with collectively bargained plans and matters impinging on the field of labor relations. By carefully assigning specific functions to each agency, the Senate bill tended to create a dominant role for each agency and minimize the degree of overlapping." III ERISA Leg. Hist. 4770.

involved the protection of the rights of participants and beneficiaries under collectively bargained pension plans.

On both occasions Congress was sufficiently concerned about the existing state of the law to make an exhaustive study thereof. In the WPPDA it made a conscious allocation between the responsibilities of the states and the federal government (see *Malone, supra*, slip op. p. 14), asserting for the latter only the task of administering the new and modest disclosure requirements which it took to be Congress' first significant entry into the pension field. And in enacting ERISA, one of Congress' principal objectives was "to reduce duplication of effort, duplication of reporting, conflicting or overlapping requirements, and the burden of compliance with such provisions by plan administrators [and] employers . . ." ERISA, § 3004(a).

The SEC's testimony and written submissions prior to the enactment of the WPPDA were of critical importance for the additional reason that, as we have seen, Congress had specifically solicited the SEC's comments and actively considered placing administrative responsibility in that agency. If Congress had been told that the Commission was already vested with authority to prevent fraud involving failure to disclose material facts with respect to pension plans, the case for the Douglas proposal would have been considerably strengthened. Indeed, if Congress had been told that as the law then stood pension plan sponsors and administrators were under an obligation to comply with the antifraud provisions of the 1933 and 1934 securities laws in dealing with covered employees, and that, but for an administrative interpretation by the Commission they were already subject to the registration requirements of the 1933 Act, Congress might have decided that no new legislation was necessary, and that the existing statutory mechanism should be utilized. Alternatively, it might have retained those laws with modifications geared to the special characteristics of pension plans.

Or Congress *might* have determined that the regulations which were actually enacted were the most desirable, that they should be subject to the jurisdiction of the Department of Labor, and abrogated the securities laws insofar as Congress was informed that they might be applicable, and thereby incorporate an express repeal. But Congress was not given reason to believe this was necessary.

The majority's erroneous perception of the SEC's representations and the Congress' general understanding when it enacted pension disclosure legislation, is of a piece with its misunderstanding of the legislative history of the securities laws and the administrative practice thereunder (see pp. 88-134 *infra*). These errors seriously undermine its interpretation of the 1933 and 1934 Acts.

But the paramount importance of this history stems from the fact that Congress has twice enacted pension legislation in reliance on the SEC's existing interpretation. Even as the SEC "is not now free"<sup>70</sup> to assert that the securities laws regulate this subject, so, too, is the courts' freedom circumscribed, for the principled basis of this rule of construction is not that the agency should be estopped, but that the manifested Congressional will should be enforced. Thus even if, as Judge Tone apparently believed, the securities laws are so elastic that the courts could permissibly have applied them to reach involuntary noncontributory pension plans absent intervening Congressional action, the enactment of WPPDA and ERISA under the circumstances detailed herein forecloses this choice. These laws embody Congressional policies concerning the regulation of pension plan disclo-

<sup>70</sup> *Bell Aerospace Co. Div. of Textron, Inc. v. NLRB*, 475 F.2d 485, 494 (C.A. 2) (Friendly, J.), quoted with approval and affirmed on this point, *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 289. Judge Friendly concluded, based on a careful examination of this Court's precedents, that "when an administrative construction has been long in effect, the agency cannot make a big change, especially after a re-enactment or substantial amendment, but can make smaller ones."

sure which the courts may not override and frustrate by rejecting the assumptions on which Congress justifiably proceeded.

A recent decision of the Court illustrates our point. In *Califano v. Sanders*, 430 U.S. 99, the question was whether § 10 of the Administrative Procedure Act, 5 U.S.C. §§ 701-706 ("APA"), is an independent grant to the United States District Courts of subject matter jurisdiction for judicial review of the actions of federal officials, a question which had sharply divided the lower courts and commentators. The Court then observed that three Court decisions had arguably assumed "that the APA is an independent grant of subject-matter jurisdiction" (*id.* at 105); nevertheless, the Court ruled to the contrary in light of subsequent legislation:

"\* \* \* However, an Act of Congress enacted since our grant of certiorari in this case now persuades us that the better view is that the APA is not to be interpreted as an implied grant of subject-matter jurisdiction to review agency actions.

"On October 21, 1976, Congress enacted Pub. L. 94-574, 90 Stat. 2721, which amends 28 U.S.C. § 1331 (a) to eliminate the requirement of a specified amount in controversy as a prerequisite to the maintenance of 'any [1331] action brought against the United States, any agency thereof, or any officer or employee thereof in his official capacity.' The obvious effect of this modification, subject only to preclusion-of-review statutes created or retained by Congress, is to confer jurisdiction on federal courts to review agency action, regardless of whether the APA of its own force may serve as a jurisdictional predicate. We conclude that this amendment now largely undercuts the rationale for interpreting the APA as an independent jurisdictional provision.

"As noted previously, the actual text of § 10 of the APA nowhere contains an explicit grant of jurisdic-

tion to challenge agency action in the federal courts. Furthermore, even the advocates of jurisdiction under the APA acknowledge that there is no basis for concluding that Congress, in enacting § 10 of the APA, actually conceived of the Act in jurisdictional terms. \* \* \* Thus, the argument in favor of APA jurisdiction rests exclusively on the broad policy consideration that, given the shortcomings of federal mandamus jurisdiction, such a construction is warranted by the rational policy of affording federal judicial review of actions by federal officials acting pursuant to federal law, notwithstanding the absence of the requisite jurisdictional amount \* \* \*. We do not find this argument to be compelling in light of Congress' apparent intention by the 1976 amendment to restructure afresh the scope of federal-question jurisdiction.

"In amending § 1331, Congress obviously has expressly acted to fill the jurisdictional void created by the pre-existing amount-in-controversy requirement. This new jurisdictional grant was qualified, however, by the retention of § 205(h) as preclusive of actions such as this that arise under the Social Security Act. Read together, the expansion of § 1331, coupled with the retention of § 205(h), apparently expresses Congress' view of the desired contours of federal-question jurisdiction over agency action. A broad reading of the APA in this instance would serve no purpose other than to modify Congress' new jurisdictional enactment by overriding its decision to limit § 1331 through the preservation of § 205(h)." (430 U.S. at 105-106, footnotes omitted.)

The parallel to the present case is precise except that we dare say that as an original proposition the argument for the jurisdictional grant in § 10 of the APA was far stronger than that for securities law jurisdiction over these private pension plans. Here, as in *Sanders*, even the advocates of coverage do not contend that Congress

"actually conceived of" the securities laws as governing those transactions. Rather, they argue that the basic policy of the securities laws would be furthered if it were held that noncontributory and involuntary pension plans are securities and that a purchase and sale is involved, and that the language is sufficiently broad to permit this result. *Sanders* teaches that the authority of the courts to construe legislation in the light of policy considerations where the Congressional will is unclear (cf. *Blue Chip*, 421 U.S. at 737) is sharply curtailed when Congress has enacted subsequent legislation on the subject in light of its own understanding of the prior law. Congress having dealt with the problem of disclosure to pension plan beneficiaries in the WPPDA on the basis that the securities laws were inapplicable, and again in ERISA on the same premise, the courts would defeat the will of the legislature by now approving a contrary interpretation of the securities laws.<sup>71</sup> It is for this reason that the true history of the SEC's position and the Congressional response provide an independent ground for rejecting the novel construction of the securities laws which the court below reached herein.

According to the Court of Appeals:

"Reading the anti-fraud provisions of the securities laws to be complementary to the requirements of ERISA makes good sense. The requirements of ERISA do not substitute for the protections afforded

<sup>71</sup> It bears emphasis that the *Sanders* decision did not independently determine that Congress' belief that the APA does not confer jurisdiction over administrative action was correct, but rather treated the fact that it so believed to be controlling. See particularly, 430 U.S. at 107, n. 7. As the Supreme Court said in another recent case, "the relevant inquiry is not whether Congress correctly perceived the then state of the law, but rather what its perception of the state of the law was." *Brown v. GSA*, 425 U.S. 820, 828. See also *Moor v. County of Alameda*, 411 U.S. 693, 709; *Bell Aerospace Co. Div. of Textron, Inc. v. NLRB*, 475 F.2d 485, 494, n. 13 (C.A. 2), *aff'd en part, rev'd in part*, 416 U.S. 267.

by the anti-fraud provisions because the securities laws require that all material facts, including, of course, risk of loss, be disclosed prior to the investment decision \* \* \* while ERISA disclosure limits itself to the plan provisions without a particularizing of how or how likely benefits may be lost (ERISA Section 102 (29 U.S.C. § 1022)) and may be made 90 days subsequent to the investment commitment. ERISA Section 104(b)(1)(A) (29 U.S.C. § 1024(b)(1)(A)). Defendants have not shown that ERISA would provide relief to persons who have acquired an interest in a pension fund where false or misleading representations have been made at inception or during subsequent ratifications or upon a job offer. Affirmance of the judgment below will supplement ERISA by providing a self-executing compulsion to disclose adequate information at such times, including a statistically determinable risk that many employees covered by a plan will never receive their pension benefits." (A. 254-255, footnotes omitted).

The court correctly identified the differences between ERISA and the antifraud provisions of the securities laws, but it gravely erred in holding that it makes "good sense" to interpret the securities laws to fill what it considers to be undesirable gaps and omissions in ERISA. The court thereby substituted its own views of public policy for those of Congress, which has the constitutional authority to make such judgments and exercised that authority only after an intensive study of the needs of private pension plans and their participants as well as of existing law.

The timing and substance of required pension plan disclosures is addressed in precise terms in ERISA, and the decision below would defeat the clear Congressional intent. The decision to allow disclosure to be made at any time within 90 days after an employee becomes a participant was a conscious Congressional decision. A requirement that an individual be given information immediately, which would be applicable under the Court of

Appeals' theory, was proposed in some early versions of ERISA but was ultimately dropped.<sup>72</sup> Moreover, it is simply not correct to say that the greater the amount of information which is provided, the better will be the employee's understanding of the pension plan. Intelligibility, rather than bombardment with detail, was the standard of disclosure deliberately chosen in ERISA.<sup>73</sup>

With a single exception, the court did not spell out what matters must be disclosed to pension plan participants under its ruling; this is presumably left "to be translated into concreteness by the process of litigating elucidation." (*Machinists v. Gonzales*, 356 U.S. 617, 619). In ERISA, by contrast, Congress specified what is required to be disclosed, and when and how, thereby creating a "safe harbor" for those who comply with the express provisions of the statute and the implementing regulations promulgated by the Department of Labor.

The one disclosure which the Court of Appeals does expressly require, calls for comment because creation of that requirement is an independent error even if the securities laws apply, and because it illustrates once again the hazards of trying to superimpose securities laws concepts onto the pension plan aspects of the employer-employee relationship.

<sup>72</sup> 503(c)(3) of H.R. 2 as it passed the Senate required the summary plan to be furnished "to every participant upon his enrollment in the plan \* \* \*" III Legislative History of the Employee Retirement Income Security Act of 1974, 3763.

<sup>73</sup> The key disclosure document under ERISA is the "summary plan description" which must "be written in a manner calculated to be understood by the average plan participant" and must cover precisely described categories of information. ERISA, § 102.

For example, the Conference Report on ERISA states: "Each administrator of an employee benefit plan is to furnish to each participant and to each beneficiary a summary plan description written in a manner calculated to be understood by the average plan participant or beneficiary." *Id.* at 4525; see also *id.* at 4665, remarks of Mr. Dent.

The court below required disclosure of what it dubs the "statistically determinable risk that many employees covered by a plan will never receive their pension benefits" (A. 255, see also A. 217, 254, 258). This ruling may reflect and its whole attitude toward the case appears to be colored by the court's perception that there is only a small "actuarial probability", which it says is "here perhaps as low as 8%," that a pension plan participant will ever obtain a vested right to a pension. But aside from the highly dubious provenance of the 8% figure,<sup>74</sup> it is entirely fallacious to treat all pension plan participants alike in their legitimate expectations and entitlements. At any moment, the total covered work force will include many individuals who continue in that employment for only a relatively short period of time, and who, therefore, are not the intended beneficiaries of the pension system (see *Alabama Power Co.*, 431 U.S. at 592); as a result of that turnover, it will inevitably happen that only a small proportion of all the individuals who have worked at any time over the years will satisfy

<sup>74</sup> The figure of 8% was injected into this case by plaintiff when he declared: "That the possibility that as many as ninety-two percent of the Local 705 Pension Trust Fund will *never* receive any retirement benefits is quite likely could not even have been imagined by such participants until the publication of various Senate Subcommittee studies beginning in 1972. See Interim Report of Activities of the Private Welfare & Pension Plan Study, S.Rep. No. 92-634, 92d Cong., 2d Sess., at 115-153 (February, 1972)." Plaintiff's Brief In Opposition To Defendants' Motion to Dismiss at 30. The cited report had nothing to do with the Local 705 plan. It analyzed a selected group of plans and, as to these, it concluded that of those employees who left their employment prior to retirement, 92 percent whose employers had plans requiring 11 or more years for vesting, left without any vested interest, and 73 percent whose employers had plans requiring 10 years or less for vesting, left without any vested interest. These percentages do not refer at all to the number of employees covered by these plans who remained employed until retirement and who then received a pension (*Id.*, pp. 125 *et seq.*)

the eligibility requirements for vesting.<sup>75</sup> Moreover, Congress in ERISA addressed the problem of harsh pension eligibility rules by establishing standards as to when vesting must occur, but declined to create retroactive vesting requirements. The court below circumvented that decision by retroactively declaring a disclosure duty with which, as far as we are aware, no pension plan has ever complied.

Even for the future, the Court of Appeals' requirement does not make "good sense". Actuarial assumptions are not actuarial facts, and even when they are based upon empirical data, they speak of a statistical universe. An actuarial assumption that half of the employees upon whose employment contributions are paid will move on to other jobs before vesting occurs says little or nothing to a 40-year-old who is prepared to make a career decision. Indeed, providing such data to an employee could be misleading where the assumption, or even the data upon which it is based, is heavily weighted by the mobility of the 20 to 30 year group. Similar problems arise when the statistical universe embraces categories as diverse as laborers and general foremen, as it so often does. In short, even "statistically" validated assumptions are valid only with respect to a statistically significant group; they are utterly meaningless for predicting the future with respect to any individual member of the group. That presumably is why Congress has not legislated the duty to provide such information; the court below should not have established that duty by judicial fiat.

<sup>75</sup> A simple mathematical example will illustrate our point. Assume an employer with two trucks. One individual works for twenty years driving the same truck. The other truck is driven successively by a series of employees who work for a few months or years, averaging two years, so that during the same twenty-year span ten individuals drive the second truck. Only the first driver obtains a pension, which is less than 10% of all the drivers who worked at all during that time.

**B. The Legislative and Administrative History of the Securities Laws Shows That They Were Not Intended to Cover Compulsory Noncontributory Pension Plans.**

**1. The Court Below Misunderstood the Reason Why Pension Plans Were Not Mentioned During the Enactment of the 1933 Act.**

It is common ground that no reference to employee pension plans is to be found in the language or history of the Securities Act of 1933. The reason, however, is not as the Court of Appeals suggested, that "in the early 1930's pension plans were still a rarity." (A. 241) By 1933, employee pension plans were by no means a rarity; they were a significant economic phenomenon affecting over 3,500,000 employees of 360 companies,<sup>76</sup> a phenomenon whose importance Congress had specifically recognized in revenue legislation as early as 1926.<sup>77</sup> The same

<sup>76</sup> Figures tabulated as of 1929 in Latimer, *Industrial Pension Systems*, 57 (1933). A 1939 Senate Report stated: "Between 1900 and 1933 some 800 industrial institutions adopted and installed pension plans affecting about 4,000,000 employees." *Survey of Experiences in Profit Sharing and Possibilities of Incentive Taxation*, Rep. of the Subcomm. of the Comm. on Finance, U.S. Senate, S.Rep. No. 610, 76th Cong., 1st Sess., 46 (the "1939 Senate Report").

<sup>77</sup> In the Revenue Act of 1926 Congress explicitly exempted from income tax trusts created by an employer as part of a pension plan for his employees. 44 Stat. 9, § 219(f). The Conference Committee on the 1926 Act observed that such pension funds were similar to stock bonus and profit sharing plans which had been exempted from income tax by Section 219(f) of the Revenue Act of 1921. 42 Stat. 22. Congress revised the tax treatment of pension plans in Section 165 of the Revenue Act of 1928, 45 Stat. 791, and made a further change in Section 165 of the 1932 Revenue Act. 47 Stat. 169. The first statutory recognition of a deduction for contributions to employee pension trusts appeared in Section 23(q) of the Revenue Act of 1928. That section was reenacted with minor changes as Section 23(q) of the Revenue Acts of 1932, 47 Stat. 169, and 1934, 48 Stat. 680. The Senate Finance Committee Report on the 1928 Act stated: "A considerable number of business concerns, however, established pension plans for the benefit of their

Congress that enacted the securities legislation of 1933 and 1934 also enacted the Railroad Retirement Act of 1934 establishing a compulsory retirement system for railroad workers.<sup>78</sup> The next Congress considered a proposal that companies which had private pension plans be exempted from the Social Security Act.<sup>79</sup>

Although in 1933 their period of greatest growth was still in the future, pension plans were already of sufficient economic importance and recognition by Congress in other federal legislation that it is more likely than not if Congress had intended them to be covered by the new securities legislation, it would have said so. The reason they were omitted was not oversight or because such

employees a good many years ago . . ." S. Rep. No. 960, 70th Cong., 1st Sess., 21-22. The history of the Federal income tax treatment of pension plans is summarized in Vol. 4A, Mertens, *Law of Federal Income Taxation*, Sec. 25B.02. (1972 revision)

<sup>78</sup> Railroad Retirement Act of 1934, 48 Stat. 1283, heard and reported in the House of Representatives by the Committee on Interstate and Foreign Commerce and in the Senate by the Committee on Banking and Currency, the same committees which heard and reported the Securities Act of 1933 and the Securities Exchange Act of 1934. Congress at that time recognized inadequacies in existing pension plans in the railroad industry:

"The record shows that there is now some form of retirement pension plan upon 90 percent of the railroad mileage in the United States. Such plans, however, are not by any means satisfactory either to the railroads or to railroad employees. In most part the pensions provided are inadequate and the cost to the railroads is mounting year by year.

"Thousands of railroad employees, retired from service because of the infirmities of age are receiving pension, if at all, in most part insufficient to provide for the comforts of life which years of honest toil should assure them." H.R. Rep. No. 1988, 73rd Cong., 2d Sess. 2 (1934). See also S. Rep. No. 974, 73rd Cong., 2d Sess. 2 (1934).

The Railroad Retirement Act of 1934 was held unconstitutional in *Railroad Retirement Bd. v. Alton R. Co.*, 295 U.S. 330.

<sup>79</sup> See testimony of Murray W. Latimer in 1941 Hearings cited p. 105 *infra* at 879.

plans "were a rarity," but that pension plans were in a different universe of discourse and were totally foreign to the sphere of commercial activity which Congress undertook to regulate in the 1933 and 1934 Acts.

The securities legislation of 1933 and 1934 was born of the economic collapse of 1929. The overall relationship of the two Acts was sketched in President Roosevelt's message of March 29, 1933, which called for legislation to require that "every new issue of securities to be sold in interstate commerce shall be accompanied by full publicity and information." The sale of worthless securities was understood to create two evils: first, tragedy in the lives of thousands of individuals who lost their life savings, accumulated after years of effort and, second, misdirection of the capital resources of the Nation.<sup>80</sup>

Traffic in "securities" is what the 1933 and the 1934 Act also were all about. The pivotal definition of "security," essentially the same in both Acts, was drawn "in sufficiently broad and general terms so as to include . . . the many types of instruments that in our commercial world fall within the ordinary concept of a security."<sup>81</sup>

This Court's early decisions interpreting "security" recognized that the definition was intended to describe instruments that were the subject of speculation or investment. *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 349, 351, 352, and *SEC v. W. J. Howey Co.*, 328 U.S. 293, 297, 298. But pension plans were not considered to be securities.

In *Railroad Retirement Bd. v. Alton R. Co.*, 295 U.S. 330, 349, 351, this Court referred to pensions as "gra-

<sup>80</sup> H.R.Rep. No. 85, 73rd Cong., 1st Sess., 2-3.

<sup>81</sup> H.R.Rep. No. 85, 73rd Cong., 1st Sess., 11, quoted in *Forman*, 421 U.S. at 851.

tuities", "consistent with the then current legal view". (A. 245). The prevailing absence of legally enforceable rights of employee participants in pension plans contrasted sharply with the position of an investor who, as the holder of an instrument "that in our commercial world [fell] within the ordinary concept of a security", had definite and enforceable rights with respect to the issuer of that security. Thus an employee's interest under a non-contributory pension plan differed *toto caelo* from the phenomena of speculation and investment dealt with in securities laws.

It is our contention that employee pension plans have been consistently viewed by Congress as part of the employer-employee relationship and have been regulated in a separate line of legislation beginning with the Labor Management Relations Act of 1947, the Welfare and Pension Plans Disclosure Act of 1958, and culminating in the Employees' Retirement Income Security Act of 1974 ("ERISA").<sup>82</sup> Congress has acted in accordance with the economic reality that compulsory non-contributory pension plans, the type of pension plan involved in this case, are part of the labor market, not the enterprise capital market, and that employer contributions to those pension plans represent a form of compensation for a lengthy period of labor not an investment by the employee within the meaning of the securities laws. The history of the federal securities laws subsequent to 1933, to which we now turn, abundantly confirms these conclusions.

<sup>82</sup> Congress has also encouraged the establishment of employee pension plans as legislative policy expressed in tax legislation, see p. 88 n. 77, *supra*.

**2. *The Inference which the Court Below Drew from the Rejection of the 1934 Hastings Amendment is Unjustified.***

The Court of Appeals sought support for its novel holding in the history of an amendment to the 1933 Act by Senator Hastings which was considered and rejected by Congress in 1934 (A. 233-234). However, an examination of that amendment and its legislative history demonstrate that it had nothing to do with mandatory, non-contributory pension plans, or indeed with the definition of "security." The amendment would have added the following provision to Section 4(1) of the 1933 Act:

"As used in this paragraph, the term 'public offering' shall not be deemed to include an offering made solely to employees by an issuer or by its affiliates in connection with a bona fide plan for the payment of extra compensation or stock investment plan for the exclusive benefit of such employees." (78 Cong. Rec. 8708)

Although the Hastings amendment was originally agreed to in the absence of objection on the Senate floor, it was eliminated in Conference. The House Managers commenting on the Conference Committee Report stated:

"The conferees eliminated the third proposed amendment to this subsection on the ground that the participants in employees' stock-investment plans may be in as great need of the protection afforded by availability of information concerning the issuer for which they work as are most other members of the public." H.R. Rep. No. 1838, 73rd Cong., 2d Sess., 41 (emphasis added to show the critical phrase omitted in the quotation at A. 233).

When the Senate took up the Conference Report, Senator Hastings complained about the action of the Conference Committee in rejecting his amendment. He said:

"I do not see why the Federal Government should insist upon having anything to do with the plan of a corporation which decides that, as a part of its policy, it will give certain additional compensation or bonus to its employees. I think that is a matter with which the Government ought not to have anything to do, and there is no public interest involved in the policy of a corporation in adopting such a plan.

"For years and years there have been discussions all over this country as to the best method of permitting employees of corporations to share in the profits of the corporations." (78 Cong. Rec. 10181)

Senator Couzens responded that "one of the controlling factors which caused the elimination of the [Hastings] amendment was the Insull transactions" in which "millions of shares of stock of Insull corporations were sold to their employees merely upon representations of the corporations themselves." The House Conferees had stressed the evils which had occurred "where employees of a number of corporations had been induced to buy shares of the stock of the corporations." *Id.* The discussion ended after Senator Fletcher intervened to state that the Conferees also believed the Hastings amendment was unnecessary since an offering limited to employees was not a public offering, an interpretation which was ultimately rejected by this Court. *SEC v. Ralston Purina Co.*, 346 U.S. 119, 126, n.13.

The history of the rejected Hastings amendment provides no support for the Court of Appeals' decision in this case. There is no mention of pension plans in the language or legislative history of the proposed amendment. The only explicit reference is to plans under which stock issued by a corporation is offered for sale to employees of that corporation. The language in the amendment relating to plans for the payment of extra compensation is nowhere explained or defined, but appears in con-

text to refer only to employee benefit plans such as stock bonus plans or profit sharing plans utilizing employer stock and which therefore clearly involve the issuance of a security.

In the 1941 hearings on the SEC's proposed amendments to the 1933 and 1934 Acts, SEC Commissioner Purcell relied upon Congress' rejection of the Hastings amendment to support the SEC position that the 1933 Act applied "to employees' plans *which involve the sale of a security*," a conclusion which says nothing about the question whether compulsory non-contributory employee pension plans "involve the sale of a security."<sup>83</sup>

There is no indication that the SEC manifested any interest in employee pension plans for several years after the 1933 and 1934 Acts. During those years employee pension plans continued to grow in size and number, stimulated by the Social Security Act of 1935.<sup>84</sup> A 1939 Senate Finance Committee Report on profit sharing plans noted the significant growth of industrial pension plans between 1900 and 1933, included a list of U.S. companies having such plans and recommended that employers who operate pension plans providing greater benefits than the federal Social Security System be exempted from that system.<sup>85</sup> Legislative attention to employee pension plans during the 1930's was also reflected

<sup>83</sup> 1941 Hearings cited p. 105, *infra*, at 895-6 (emphasis added). Mr. Purcell also referred to the Congress' 1934 action as having "made it quite apparent to the Commission that Congress intended investments in employees' plans to be included within the term 'security'." (*Id.* at 895). This statement must be read in the context of his entire testimony which related only to contributory employee plans and not to the types of pension plans involved in this case. See pp. 105-110, *infra*.

<sup>84</sup> 1941 Hearings, at 866 (Testimony of Murray W. Latimer).

<sup>85</sup> 1939 Senate Rep., op. cit. p. 58, n. 76, *supra*, at 46, 192-197, 252-256.

in the Railroad Retirement Act of 1937, 50 Stat. 307, and in a series of revenue acts.<sup>86</sup>

### 3. *The Investment Company Act of 1940 Cuts Against the Conclusion That There Is a "Security" Here.*

a. Referring to Congressional testimony given in 1941 by SEC Commissioner Purcell (see pp. 105-112, *infra*) the Court of Appeals said:

"Commissioner Purcell also noted that the 1940 Congress was aware of the economic congruence between employee pension plans and ordinary mutual funds because it defined an 'employees' security company' as one type of 'investment company' in Section 2(a) (13) of the Investment Company Act of 1940. 1941 Hearings at 895. Consequently, an employee pension plan is regulated by the 1940 Act unless it falls within an exemption from registration. See, e.g., 15 U.S.C. §§ 80a-3(c) (11) and -6b." (A. 234).

Our examination of the Investment Company Act of 1940 (hereafter "1940 Act") shows that the Court of Appeals erred in its view that pension plans are "congruent with" employees' securities companies and therefore are investment companies regulated under the 1940 Act unless

<sup>86</sup> The deduction provisions of Section 23(q) of the Revenue Act of 1928 relating to contributions to employee pension trusts were reenacted as Section 23(p) under the Revenue Acts of 1936, 1938 and 1939 and the employee trust exemption was reenacted as Section 165 of those Acts. A regulation promulgated under Section 165 of the Revenue Act of 1938 provided for disclosure of the pension plan to employee participants. The regulation stated:

"A 'stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of some or all of his employees' is a definite written program signed by such employer and *communicated to such employees*. . . ." (emphasis added) Regs. 101, Art. 165-1 (1938).

This regulation was repromulgated under Section 165 of the Internal Revenue Code of 1939, Regs. 111, § 29.165-1 (1939).

exempted. Pension trusts and employees' securities companies are given totally different treatment under that Act. Congress did then decide to regulate employee investment plans, but at the same time it said that qualified employee pension trusts are not investment companies under the Act. The specific *exclusion* of these employee pension trusts from the 1940 Act supports our contention that Congress has never regarded employee pension plan participants as investors intended to be protected by the federal securities laws. Moreover, even on the court's reading of § 2(a)(13), it is fallacious to conclude that Congress believed that all types of employee pension plans, let alone involuntary noncontributory plans would have been subject to the Act but for its exemption provisions.

a. As this Court observed in *United States v. National Assn. Securities Dealers*, 422 U.S. 694, 704-706, the basis of the 1940 Act was the Investment Trust Study which had been ordered by Section 30 of the Public Utility Holding Company Act of 1935, 49 Stat. 837, 15 U.S.C. § 79z-4. The overall purposes of the 1940 Act have been described by a Chairman of the SEC as follows:

"The Investment Company Act of 1940 goes beyond disclosure and introduces various substantive regulatory provisions which are deemed necessary where a security involves a participation in a pool of liquid assets. . . . [I]t seeks to protect investors in three primary ways. First, by providing continuing disclosure, which supplements disclosures obtained under the Securities Act. Second, by giving investors a voice in the determination of questions vital to their interests, such as changes in basic investment policy, the adoption, renewal, assignment or termination of investment management contracts and other important matters. . . . Third, the Investment Company Act prohibits or conditions certain transactions or relationships which may give rise to a conflict of

interest between the investors and those who are managing their money."<sup>87</sup>

See also the Findings and Declaration of Policy in § 1 (a) of the 1940 Act.

Coverage under the 1940 Act turns on § 3(a), which defines an "investment company" as any "issuer" that falls within any of the three subdivisions of that section. "Issuer" is defined in § 2(a)(22)<sup>88</sup> as "every person who issues or proposes to issue any security, or has outstanding any security which it has issued." "Security" is defined in § 2(a)(36) in the same terms as in § 2(1) of the 1933 Act. As originally enacted, § 3(c)(13) (revised as § 3(c)(11)), said with unmistakable clarity that employee pension trusts are *not* investment companies:

"(c) Notwithstanding subsections (a) and (b), none of the following persons is an investment company within the meaning of this title:

\* \* \*

(13) Any employees' stock bonus, pension or profit-sharing trust which meets the conditions of section 165 of the Internal Revenue Code." 54 Stat. 798, 799.<sup>89</sup>

<sup>87</sup> Testimony of SEC Chairman Manuel F. Cohen. Collective Investment Funds, Hearings before a Subcommittee of the Committee on Banking and Currency, U.S. Senate, 89th Cong., 2d Sess. on S. 2704, at 134 (1966).

<sup>88</sup> For convenience we shall, except where noted otherwise, refer to the present, rather than the original, section number.

<sup>89</sup> The fact that § 3(c)(13) refers to employee pension *trusts* and not to pension *plans* has made no difference in the view of the SEC. The SEC's Institutional Investor Study of 1971 stated, with reference to § 3(c)(13):

"Since these trusts are exempt only if they are part of qualified plans, the Commission staff has interpreted the exemption as applying also to the related plan or plans." *Id.* at 998.

Although § 3(c)(13) also refers to two other types of employee benefit plans, for convenience we will refer to it only as it relates to pension plans.

By contrast, an "employees' securities company" is defined in § 2(a)(13) of the 1940 Act as

"any investment company or similar issuer all of the outstanding securities of which (other than short-term paper) are beneficially owned (A) by the employees or persons on retainer of a single employer or of two or more employers each of which is an affiliated company of the other, (B) by former employees of such employer or employers, (C) by members of the immediate family of such employees, persons on retainer, or former employees, (D) by any two or more of the foregoing classes of persons, or (E) by such employer or employers together with any one or more of the foregoing classes of persons." 15 U.S.C. § 80a-2(13).

An employees' securities company is essentially a special type of investment company whose securities are owned by an employer and his employees and was so understood in the investment trust study.<sup>90</sup> On the other hand, there was no discussion whatsoever of employee pension trusts in that study, an omission which is particularly instructive because the Report was unusually comprehensive. Appendix A to Part I of the Report lists by name "all the investment companies known to the Commission." While a few employees' securities companies can be identified (Electrical Securities Corporation, Elfun Trusts, G.E. Employees Securities Corporation), the list contains nothing described as an employee pension plan.

Unlike employee pension trusts which are excluded by § 3(c)(13), employees securities companies are specifi-

<sup>90</sup> This type of investment company was described in the first part of the SEC Report, *The Nature, Classification, and Origins of Investment Companies*, H.R.Doc. No. 707, 75th Cong., 3d Sess., 95-97 (1938). Under the heading "Use As An Investment Medium For A Particular Class Of Persons", the Report identified the G.E. Employees' Securities Corporation as "a company set up by an industrial concern for the investment of savings by employees."

cally covered by the Act, subject to administrative exemption by the SEC under § 6(b) "if and to the extent that such exemption is consistent with the protection of investors." The Court of Appeals also confused the *exclusion* provisions of § 3(c)(13) and the *exemption* provisions of § 6(b).<sup>91</sup> (A. 234-235).<sup>92</sup>

That the SEC understood the fundamental difference between pension trusts and employees' securities companies under the 1940 Act is shown by *Electrical Securities Corporation*, 10 SEC Jud.Dec. 648, a ruling issued on December 1, 1941. Electrical Securities Corporation had applied for an exemption order pursuant to Section 6(b) of the 1940 Act. The applicant was a corporation whose principal function was to provide a medium for investment of the funds of the General Electric Pension Trust, a non-contributory retirement plan established for the benefit of approximately 50,000 employees and former employees of the General Electric Company and affiliated companies. The Commission distinguished between the applicant, which it found to be an employees' securities

<sup>91</sup> Section 6(b) provides in full:

"Upon application by any employees' security [sic] company, the Commission shall by order exempt such company from the provisions of this title and of the rules and regulations hereunder, if and to the extent that such exemption is consistent with the protection of investors. In determining the provisions to which such an order of exemption shall apply, the Commission shall give due weight, among other things, to the form of organization and the capital structure of such company, the persons by whom its voting securities, evidences of indebtedness, and other securities are owned and controlled, the prices at which securities issued by such company are sold and the sales load thereon, the disposition of the proceeds of such sales, the character of the securities in which such proceeds are invested, and any relationship between such company and the issuer of any such security." 15 U.S.C. § 80a-6(b).

<sup>92</sup> The same confusion is reflected in the Purcell testimony and the 1972 Congressional testimony of former SEC Chairman Cohen referred to at A. 234 and A. 235, n. 31.

company entitled to request exemption under § 6(b), *id.* at 650 and the General Electric Pension Trust, which "falls within the provisions of Section 3(c)(13) and, therefore, is *not* an investment company within the meaning of the Act" (*Id.* at 649). It said also "that the pension trust is an employee's [sic] plan that is *not in the purview of the Act.*" (*Id.* at 650) (emphasis added).

The *Electrical Securities* decision is significant also because the Commission concluded that the applicant should be exempted from all of the provisions of the Act in part on the ground that the pension trust was noncontributory. The SEC twice stressed that the employee participants had made no contributions to the pension trust.

"It is important to note that these assets [of the Pension Trust] were contributed by General Electric and its affiliated companies, and *do not represent funds advanced by the employees who may be eligible for retirement benefits . . .*

. . . . .

"Thus, we find that the notes held by the Pension Trust are purchased *only* with funds advanced by General Electric and certain of its affiliates to the Pension Trust . . ." (*Id.* 649, 651) (emphasis added).

The Commission concluded that the "protection of investors" standard of § 6(b) had been met, listing as the first of its reasons that the investment company was used as the medium for the investment of funds all of which were contributed by the employer; it then granted an exemption from all of the provisions of the 1940 Act on the condition that certain periodic reports be filed with the Commission. (*Id.* at 650-651). This decision contrasts sharply with that issued the same day in *G.E. Employees' Securities Corporation*, 10 SEC Jud. Dec. 652, wherein the Commission denied a broad exemption to a corporation whose stock was owned by the General Electric Company and which sold its debenture bonds to

employees and pensioners of that company and affiliated companies and promissory notes to the General Electric *Additional Pension Trust*, which was a *contributory* pension plan. (*Id.* at 654).

Thus, the Commission's ruling recognized that a pension trust and an employees' securities company were different entities under the 1940 Act and that pension trusts were outside the purview of the Act. And in emphasizing the fact that all contributions to the General Electric Pension Trust were made by the employer, the Commission acknowledged the distinction between contributory and non-contributory plans which the SEC and the Court of Appeals have attempted to obliterate in this case.

In sum, the language of the statute and its history, confirmed by a contemporaneous SEC ruling, show that the Court of Appeals was mistaken in assuming that pension trusts are employees' securities companies and investment companies regulated by the 1940 Act unless covered by an exemption.

But this is not all. Although it theorized that employee participants in a compulsory non-contributory pension plan are investors whose "interest" in that plan is a security, the Court of Appeals offered no explanation as to why Congress entirely excluded them from the protections of the 1940 Act. Similarly the court offered no explanation for the absence of any discussion of employee pension plans in the SEC Report which was the principal basis for that Act. On the other hand, §§ 2(a)(13), 3(c)(13) and 6(b) of the 1940 Act show that Congress then considered the subject of employer-employee relationships and decided which of those relationships were appropriate subjects for the type of regulation provided in the 1940 Act. The exclusion of employee pension trusts in Section 3(c)(13) and the failure to mention them in the SEC Report may both be explained on the basis of Congress'

and the SEC's recognition that employee participants in such pension plans are not investors within the meaning of the federal securities laws. Thus the 1940 Act is evidence which cuts against the holding of the court below.

b. The Court of Appeals inferred from what it thought was the Congressional decision that employee pension plans are regulated by the 1940 Act unless they are exempted, that Congress must have believed such plans to be employees' securities companies. But even if one were to follow the Court to that point, the most that could be inferred is that Congress believed *some* employee pension plans might be employees' securities companies, which would say nothing about whether Congress believed any particular type of pension plan, such as involuntary, noncontributory plans, to be securities. Employee pension plans can be treated as identical for the purposes of their treatment under the 1940 Act and the securities laws generally, only by ignoring the distinctions between involuntary and voluntary plans and between noncontributory and contributory plans (and, within the latter category, between those which are and those which are not utilized for the purchase of the employers' own stock). There is no evidence that Congress was similarly indiscriminating, and as we have seen, the SEC distinguished between contributory and noncontributory plans in its decisions involving trusts established by the General Electric Company. As we next show, the 1941 testimony of SEC Commissioner Purcell and the 1941 opinion of an SEC Assistant General Counsel, on which the Court of Appeals relied (A. 234-235) also carefully distinguished between these two types of employee pension plans in determining whether they involve a "security." That evidence, like that of the 1940 Act itself, will thus be seen to further undermine the court's description of the prior understanding of the securities laws.

**4. *The 1941 SEC Opinions and Testimony Establish that the SEC Did Not Then Consider Compulsory, Noncontributory Pension Plans to Be Securities.***

**a. *The Opinions.***

In September 1941 the SEC published two opinions of Assistant General Counsel John F. Davis which set forth the position which the SEC was to follow for the ensuing three decades (with a modification in 1953 to be noted later) on the status of employee pension and profit sharing plans under the Securities Act of 1933. CCH Fed. Sec.L.Rep., 1941-1944 Dec. ¶ 75,195, p. 75,386. This position was:

1. Certain types of voluntary contributory plans involve the sale of a security and are subject to the Act.
2. Compulsory plans and non-contributory plans are not subject to the Act because they do not involve an offer or sale within the meaning of the Act.

As to "certain types of voluntary contributory plans," a security may be present, either an investment contract or a certificate of interest or participation in a profit sharing agreement.<sup>93</sup> Also, voluntary contributory plans involve a "sale" under Section 2(3) of the 1933 Act since

<sup>93</sup> "The Commission has always taken the position that the offer or sale of interests in *certain types of voluntary, contributory plans* is subject to the registration and prospectus requirements of the Securities Act of 1933, unless one of the general exemptions in Sections 3 and 4 of the Act is available." (emphasis added) (*Id.* at 75,386).

"You are correct in surmising it to be our position that the security which is involved within the meaning of Section 2(1) of that Act in connection with the offer or sale of interests in *certain types of plans* is normally an 'investment contract.' Frequently the interests may come also within the phrase 'certificate of interest or participation in a profit-sharing agreement.'" (*Id.* at 75,387) (emphasis added)

"... it is our position that, wherever a plan involves an investment contract or certificate of interest or participation in a profit-sharing agreement and *the employees have a choice whether or not to make contributions*, there is obviously an 'attempt or offer to dispose of \* \* \* a security \* \* \* for value.'" (emphasis added, ellipses in original) (*id.* at 75,387)

Compulsory and non-contributory plans are not subject to the Act because no sale is involved:

"On the other hand, it is because of the language of Section 2(3) that we have taken the position in the past that no 'offer' or 'sale' is involved in the case of a non-contributory plan, where the employees are not requested to make any contributions, or in the case of a compulsory plan, where there is no element of volition on the part of employees whether or not to participate and make contributions." (*Id.*)

Contrary to the Court of Appeals, the 1941 opinions did not say "that 'security' within the definition of the 1933 Act included employee pension plans." (A. 234). The first opinion stated only that "*certain types* of voluntary contributory plans" (emphasis added) were subject to the registration and prospectus requirements of the 1933 Act. And the second opinion stated that "interests in *certain types* of plans" (emphasis added) were normally an investment contract or in other cases a certificate of interest or participation in a profit sharing agreement. Nowhere is there a suggestion that interests in compulsory and non-contributory pension plans are securities under the 1933 Act.

The Court of Appeals also erred in suggesting that the "no sale" interpretation set forth in the 1941 opinions with regard to compulsory and non-contributory plans was limited to the registration as opposed to the antifraud provisions of the 1933 Act. (A. 246). The opinions themselves negate this suggestion. Their statement of "the question of finding a 'sale' within the mean-

ing of Sec. 2(3) of the Act" and their conclusion that such plans do not involve an "offer or sale" necessarily meant that the entire Act was inapplicable since the sale of a security is required to bring either the registration or the antifraud provisions of that Act into play.

#### b. Commissioner Purcell's Testimony.

Three months after publication of the 1941 opinions the SEC presented certain proposals dealing with pension and other employee benefit plans to the Committee on Interstate and Foreign Commerce of the House of Representatives.<sup>34</sup> Hearings before the House Committee on Interstate and Foreign Commerce, 77th Cong., 1st Sess., 895 ("1941 Hearings").

<sup>34</sup> On August 7, 1941 the SEC had issued its Report on Proposals for Amendments to the Securities Act of 1933 and Securities Exchange Act of 1934. H.R. Comm. Print, 77th Cong., 1st Sess. Two of the proposed amendments to the 1933 Act related to pension plans and other employee benefit plans. The first provided for an exemption from registration for those "types of plans [that] contain provisions sufficiently safeguarding the interests of employees to warrant their being automatically exempted from the registration requirements of the Act." (*Id.* 15.) The second proposal would have given the Commission rulemaking authority to exempt from registration plans which did not meet the requirements for automatic exemption.

The reach of the proposals described in the August 1941 Report was then unclear. If both proposals had been adopted, application of the 1933 Act would still have required the presence of a "security" and a "sale." The proposals on their face did not disclose what types of employee plans were believed to be subject to the 1933 Act as it then stood and therefore required statutory exemption to be relieved from the registration requirement; but the references to employee contributions in the Report (*Id.* 15-16) show that the SEC's proposals were developed to distinguish the treatment of different types of voluntary contributory plans. The two opinions of the SEC Assistant General Counsel published one month later clarified that what was at issue was an effort by the SEC to apply the Securities Act to certain voluntary contributory employee pension and other benefit plans but not to compulsory noncontributory plans.

The few reported instances in which the SEC had begun to seek registration of employee benefit plans under the Securities Act

The SEC was represented by Commissioner Ganson Purcell. He did not argue, as the Court of Appeals implies at A. 234-235, that interests in *all* pension plans were securities nor did he suggest that the "no sale" interpretation of the Commission with respect to compulsory and noncontributory plans was limited to the registration provisions of the Act. (Cf. A. 245-246). No suggestion is to be found anywhere in his testimony that such plans are securities or that they are subject to the antifraud provisions of the Act. Rather, he reiterated the interpretation which had been set out in Assistant General Counsel Davis' opinions: (1) that certain voluntary contributory plans involve the sale of a security, are therefore subject to the Act and required to be registered unless a specific exemption is available, and (2) that compulsory and noncontributory plans are not subject to the Act because they do not involve a sale.

In defending his position that the Securities Act applies to *some* pension plans, Commissioner Purcell was speaking only of voluntary, contributory plans. This is clear from his reference to "• • • any plan under which employees are given the *opportunity* to place part of their earnings in a fund which is to be invested for their benefit and returned to them at a later date." (1941 Hearings 895, emphasis supplied). The kind of plan to which Mr. Purcell was addressing himself is further shown by his statement that "many [not, "all"] employee plans are

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confirm this view. In 1938 the Commission demanded registration of the Sears, Roebuck Profit Sharing Plan, a voluntary contributory plan which invested principally in Sears stock. Harbrecht, *Pension Funds and Economic Power*, 85-90 (1959). The Sears Plan filed a registration statement in 1940, said to be the first such statement to be filed. (1941 hearings, 974, 1021). In February 1940 the SEC demanded registration of a voluntary, contributory profit sharing plan maintained by Jewel Tea Company, a demand which was refused by the company. The SEC told that company that if the plan were made compulsory the registration demand would be dropped. (1941 Hearings, 962, 963).

in the nature of investment trusts and are indistinguishable in legal effect from investment companies offering securities to the public at large", *id.*, and by his reliance on Congress' rejection in 1934 of the Hastings amendment relating to employee stock investment plans. (See pp. 92-94, *supra*)

That Mr. Purcell believed the Securities Act to apply only to voluntary contributory plans is revealed by other portions of his testimony.

"Mr. Chairman, I should like to make as clear as possible at the outset of my remarks the nature of the proposals that are now being considered by the committee. I would like to call your attention to the fact that we are not proposing that pension plans be made subject to the Securities Act. *Certain plans are now subject to the Securities Act and the registration requirements*, as Mr. Latimer stated yesterday and as I will explain in detail in a few minutes. (*Id.* 887-888) (emphasis added)."<sup>95</sup>

\* \* \*

"Well, our view of it is that there is substantially the same situation in either case. In one, *the employees are being offered the securities of a company directly and being encouraged, as you say, to invest in them and take an ownership interest in the company*. If they are supplied with the information that is required under the Securities Act, the company has met the requirements of disclosure of the Securities

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<sup>95</sup> Mr. Murray W. Latimer, the Chairman of the Railroad Retirement Board and a leading expert on pensions (see *id.* at 865) testified in support of the Commission's proposals. It is clear from his testimony that the plans which he believed to be subject to the Securities Act, and as to which he was asserting the Commission's position (see particularly *id.* at 873, 878, where representatives of the Commission were nodding approval) were *contributory, voluntary* plans—that is, plans to which the employees contributed money and had a choice as to whether to contribute. See *id.* at 871-873, 874, 876, 877-878, 880-883.

Act. Now, if the pension or other type of investment plan is going to take the employees' money and invest it directly in the stock of the company, then it is the view of the Commission that under disclosure principles the employee ought to know that that is going to be done when he is asked to participate in the plan. *That is all that is suggested.*" (*Id.* 903) (emphasis added).

Mr. Purcell also made clear that compulsory and non-contributory plans were *not* subject to the 1933 Act.

"Now, in anything that I have said, I do not mean to imply that every employees' plan requires registration. *It is only those plans which involve the sale of an investment contract or some other type of security.* Obviously I am not talking about plans which provide simply for sick benefits or hospitalization or social and cultural activities. *The Securities Act does not apply unless the employees' payments are made with a view to their being invested and earning a return for them.*

"Moreover, *even where the plan involves securities, registration is not required in the many cases where the employees pay nothing for the securities, but receive an interest in an investment fund by way of bonus from their employer; for, of course, a gift is not a sale, and the Securities Act is concerned only with sales of securities.*

"Similarly, compulsory plans do not require registration. *If a plan is so set up that participation in it is a condition of employment, the Commission has taken the position that, as in the case of a noncontributory or bonus plan, there is no sale involved.* The purpose of the registration provisions of the Securities Act is to disclose to prospective investors the essential facts about *securities which they are asked to buy, and if the employees are given no choice as to whether to buy or refuse to buy there*

hardly seems any point in the registration process. As a practical matter, people do not decide, it seems to me, to take jobs or leave them because they like or dislike the company's investment plan.

"Finally, even where there is a sale—that is, *where the employees are given a choice whether or not to contribute*—an exemption may be available if all the funds must be invested in insurance policies and annuities, as Mr. Latimer indicated this morning . . ." (*Id.* at 896-897) (emphasis added).

Mr. Purcell's understanding that compulsory and non-contributory plans were not subject to the 1933 Act was further shown by his repeated references to voluntary plans and employee contributions (*id.* 902, 904, 910), and his repeated insistence that his concern was limited to plans which involve the sale of a security (*id.* 900, 901, 913).<sup>96</sup>

<sup>96</sup> Industry witnesses who followed Mr. Purcell also indicated that this was their understanding of his position, *id.* 983, 987, 988. They testified that for several years after the 1933 Act the SEC had made no such claim although many registration statements had been filed by corporations offering securities which mentioned the existence of such plans. (*Id.* 951, 997). One witness pointed out that although hundreds of plans were in existence at the time of the 1933 Act and many more had been adopted since then, there had been no example of voluntary registration of such a plan and it was unreasonable to suppose that the trustees of all such plans had violated the law for all those years (*id.* 968). Industry witnesses testified that the Commission's claim of jurisdiction over voluntary contributory plans announced in the 1941 opinions and in the SEC's amendment proposals had come as a surprise. (*Id.* 923, 932, 974, 994, 997). They uniformly urged that, except for employee stock investment plans, voluntary contributory pension plans were not subject to the Securities Act. (*Id.* 926, 933, 950, 965, 996-7, 985). They echoed Congressman Wolverton's position that pension plans had not been considered in connection with the Act and that the SEC's recent claim in this regard was a distortion of the purposes of that Act. (*Id.* 927, 951, 965, 997). Several witnesses warned that approval of the Commission's proposals would discourage the establishment of retirement plans by employers. (*Id.* 945, 953, 957, 971, 985, 992-4).

The Court of Appeals accepted the SEC's argument below that the Commission's "no sale" interpretation with respect to compulsory and non-contributory pension plans, as expressed in the 1941 opinions and in Commissioner Purcell's 1941 testimony, was reached only for purposes of the registration provisions and was never applied for purposes of the antifraud provisions of the Securities Act. (A. 245-246). The 1941 opinions, as we have seen, cannot be read in this way; nor can Mr. Purcell's testimony. Nowhere in its 1941 presentation to Congress did the SEC say that it believed the anti-fraud provisions were applicable to compulsory non-contributory plans. Although Mr. Purcell's testimony focused on the registration requirements of the Act, he did not say that the "no sale" interpretation which he espoused with respect to compulsory and non-contributory pension plans applied to the registration but not the antifraud provisions of the Act.<sup>97</sup>

Even Mr. Purcell's limited assertion of authority was challenged in the course of the Commissioner's testimony

<sup>97</sup> Such a distinction would have been inconsistent with the plain language of the 1933 Act, which contains only one definition of the term "sale" and no language indicating that the term means one thing for purposes of the registration provisions and another thing for purposes of the other provisions of the Act which depend on the presence of a sale.

This distinction also would have been inconsistent with the position which the SEC took in a brief *amicus curiae* filed in March, 1941 in *National Supply Co. v. Leland Stanford Junior University*, 46 F.Supp. 389 (N.D. Cal.), *aff'd.*, 134 F.2d 689 (C.A. 9), *cert. denied*, 320 U.S. 773. In that case the SEC argued that where no "sale" was involved within the meaning of the 1933 Act a purchaser was barred from suing both under § 12(1) which creates civil liability for violation of the registration requirements of the Act and § 12(2) which creates civil liability for the use of untrue statements or omissions of material facts in the sale of securities. Brief of the Securities and Exchange Commission as *amicus curiae* in No. 20462 (U.S.D.C.N. Cal.) pp. 2-3, 17. The SEC reiterated that position on plaintiff's appeal in that case. Brief of the SEC in No. 10272 (C.A. 9), pp. 6, 8, 15-16.

and that of other witnesses by Congressman Wolverton, who had been a member of the House committee which initially considered the 1933 Act (1941 Hearings at 877), and who insisted that the entire subject of pension plans was "far afield" from the Securities Act. (*Id.* at 870-872). Congressman Wolverton said:

"I was a member of this committee when the Securities Act was enacted. The matters that you are now bringing to our attention, to the best of my knowledge and recollection, were never even mentioned in connection with the Securities Act. This is something totally foreign to what we had under consideration at that time.

• • •

"We were seeking to protect the public against the issuing of improper securities; to give it all of the information that would enable it to know whether it was getting something good or something bad; but the question of pensions and their funds, or the investment of the funds, was never even a subject of discussion before the committee . . ." (*Id.* at 878)

• • •

"Well, the more you talk, and the longer I listened to Mr. Latimer, the more I am impressed with the thought that the subject is so big, of such a character, and covers a field so wide that it should be a matter of special legislation, if it is necessary, and not to be tacked on to the Securities Act like a wart to something that was never intended to apply to it. It just seems to me that you are driving something in that never was in contemplation when we passed this Securities Act." (*Id.* at 913)

• • • • •

"I do not think I can emphasize too strongly the lack of congressional intent in the passage of the Securities Act to include jurisdiction in these matters that have been assumed by the Securities and Exchange Commission.

"Speaking for myself, as I have stated on several occasions, I have no recollection of any request for that power having been presented to the Commission when we were considering the bill on the floor of the House, nor in the Senate. I cannot conceive that a matter that is as important as this seems to me, if we are to judge by the interest that has been taken in these hearings, that a matter of that kind could be made a part of this bill without some discussion or some reference to it in some way, and yet there is an absolute lack of any reference of that kind, which leads me to the conclusion that others as well as myself did not have in mind that it was in any way intended to be included, nor that the bill as enacted, had any bearing on this particular subject." (*Id.* at 980-981)

The Court of Appeals was plainly mistaken in suggesting that Congressman Wolverton's statements dealt only "with supervision" or "regulation", by which it meant registration under the 1933 Act (A. 235, n.32). He could not have expressed more emphatically his view that the subject matter of employee pension plans was "totally foreign" to the 1933 Act in its entirety. And, as we have seen, he not only reflected the views of the 1933 Congress, but anticipated the course of future Congressional action: For when Congress determined to regulate private pension plans, it did so in 1958 and again in 1974, as "a matter of special legislation" rather than "tack[ing] it on to the Securities Act like a wart. . . ." (1941 Hearings at 913).

**5. *The SEC's Administrative Practice after 1941 Was, As Before, to Treat Compulsory Noncontributory Pension Plans As Beyond the Purview of the Securities Laws.***

After the SEC failed in its 1941 effort to gain express statutory authority over voluntary contributory plans, it evidently abandoned further efforts to apply the Securities Act to most plans of that type. During his 1941

testimony Commissioner Purcell told the House Committee that the SEC had decided to withhold further action under the Securities Act relating to the employee benefit plans which it believed to be subject to registration, pending Congressional action on its proposals (1941 Hearings at 914). It appears that prior to 1951 companies were advised by the SEC "that plans under which any contributions were invested in employer stock had to be registered."<sup>88</sup> In 1948 a commentator reported that the Commission, upon direct inquiry, had advised that suitable forms for the registration of pension plans were not then available.<sup>89</sup>

In 1951 Louis Loss, then Associate General Counsel of the Commission (and a signatory of the Ninth Circuit brief in *Leland Stanford*) after referring to the Commission's unsuccessful 1941 amendment proposals, and its stated intention to withhold further action until Congress had acted, said, "Nothing further has been done as of this writing." Loss, *Securities Regulation* 329 (1st ed. 1951).

In 1953 the SEC belatedly acknowledged the abandonment of its earlier efforts to compel registration of all voluntary, contributory pension plans under the Securities Act. Letters from the Assistant Director of the Commission's Division of Corporation Finance formally announced the much narrower policy that registration was required only for contributory plans which used employee contributions to purchase employer securities. These 1953 letters stated:

<sup>88</sup> Mundheim and Henderson, *Applicability of the Federal Securities Laws to Pension and Profit-Sharing Plans*, 29 *Law and Contemporary Problems*, 795, 809, n. 45 (1964) (hereinafter *Mundheim and Henderson*).

<sup>89</sup> Comment, *Pension Plans As Securities*, 96 *U.Pa. L. Rev.* 549, 550 (1948).

"pending the adoption of a suitable form, no question will be raised with respect to the registration of participants in a voluntary, contributory pension, profit-sharing, or similar plan that does not invest in the securities of the employer company in an amount exceeding the company's contributions."

Letters dated May 12, 1953 from the Assistant Director, Division of Corporation Finance of the Commission to Commerce Clearing House, CCH Fed.Sec.L.Rep. ¶ 2105.51 and to Prentice-Hall, P-H Pension and Profit Sharing Rep. ¶ 11941 (1971).<sup>100</sup>

Nothing was said in the 1953 letters about compulsory non-contributory pension plans. The conclusion in the 1941 opinions that such plans did not involve a sale and were therefore not subject to the Securities Act was generally understood to be unchanged<sup>101</sup> and was expressly reaffirmed as current staff policy in letters dated August 1, and November 16, 1962 from the Chief Counsel of the SEC Division of Corporation Finance to Commerce Clearing House, CCH Fed.Sec.L.Rep. ¶ 2105.52 and to Prentice-Hall, P-H Pension and Profit Sharing Rep. ¶ 11941 (1971). And as we have seen, the SEC Institutional Investor Study of 1971 reaffirmed the Commission's long-standing interpretation that the Securities Act does not apply to compulsory, non-contributory pension plans. *Supra*, pp. 58-60.

After the enactment of WPPDA, the SEC recognized the 1958 law as Congress' chosen instrument for protect-

<sup>100</sup> One month later the SEC adopted Form S-8, a simplified registration form for employee stock purchase plans of companies which already filed reports under the 1934 Act. Securities Act Release 3480, June 16, 1953. *Loss, Securities Regulation* 319, n.9 (2d ed. 1961).

<sup>101</sup> For references to this understanding see *Loss, Securities Regulation*, 326-329 (1st ed. 1951); *Id.* 327-328 (Supp. 1955); *Id.* 506-511 (2d ed. 1961); *Id.* 2551-2556 (Supp. 1969).

ing the rights of employee pension plan participants. The 1963 SEC Special Study of Securities Markets said:

"While pension funds are one of the most important institutional groups in the securities markets, and are growing at the fastest rate, they are notable for the dearth of information publicly available on their holdings. Investment companies are required by the provisions of the Investment Company Act to disclose their holdings of individual stocks in their periodic reports. Insurance companies are required by various State statutes or regulations to make similar disclosures. *Pension funds, however, have not been subject to any corresponding disclosure requirement.* Although the Federal Welfare and Pension Plans Disclosure Act applies a disclosure concept to pension funds, the act does not require that the holdings of individual security issues be revealed unless they are securities of an employer or other 'party in interest', and are not securities listed on a national securities exchange or securities of a registered investment company or public utility holding company.

"Recommendations have been made in the past by others that the Federal Welfare and Pension Plans Disclosure Act should require greater disclosure of individual security holdings of pension funds, *with the purpose of informing, and protecting the interests of, the beneficiaries of such plans.* In view of the general importance of the pension funds in the securities markets, however, there appears an independent reason of public policy favoring such disclosure."<sup>102</sup>

At no time did the Commission proceed against any involuntary noncontributory pension plan under the anti-fraud provisions for making material misstatements to

<sup>102</sup> Report of Special Study of Securities Markets of the Securities and Exchange Commission, Part II, House Document No. 95, 88th Cong., 1st Sess., 869 (1963) (emphasis supplied).

pension plan participants or for failing to disclose material facts to them. In fact, its practice was in full accord with its statement of the law in the 1971 Institutional Investor Study and in its presentations to Congress when the WPPDA and ERISA were enacted. The Court of Appeals unaccountably failed even to mention this long and uninterrupted history of inaction. Instead, it placed its heaviest reliance on a 1970 amendment to the 1933 Act which, as we now show, the court completely misinterpreted.

**6. The 1970 Amendment to the 1933 Act Has No Bearing on The Question Before the Court.**

**a. Introduction.**

The Court of Appeals placed heavy reliance on an amendment made to § 3(a)(2) of the 1933 Act by § 27 (b) of the Investment Companies Amendments Act of 1970 (the "1970 Act"). The change in § 3(a)(2) is set forth at pp. 3a-5a, *infra*. The court said: "Recognizing that interests in employee pension funds are 'securities,' in 1970 Congress decided to exempt them from the registration requirements of Section 5 of the 1933 Act (15 U.S.C. § 77e) if the employee pension fund was maintained by a bank or in a separate account maintained by an insurance company." The court drew from that interpretation two propositions which were critical to its ultimate judgment. *First*, that Congress thereby "evidenced agreement with the SEC's position that interests in pension funds are securities;" and *second*, that by virtue of those amendments nearly all pension funds are exempt from registration. (A. 236-238, 252, 258.)

The first proposition is wrong because, as we shall show, the 1970 amendment did not address the relationship between employee participants and pension plans or trusts at all, but rather only the relationship between banks or

insurance companies which offer bank trust funds or separate insurance accounts as investment vehicles for pension fund assets and those who are responsible for determining the manner in which such assets will be invested.

The second proposition is wrong because contrary to the assumption of the court below that 96% of all pension funds are bank maintained and hence exempt from registration by reason of the 1970 amendment (A. 258, n.61), the SEC's own statistics show otherwise. While we do not have information which would show the number of pension funds that have their assets managed otherwise than by banks or insurance companies, a study issued by the SEC itself shows that at the end of 1975, of the aggregate \$145.6 billion asset value of all private noninsured pension funds, only \$93.5 billion were managed by banks and trust companies. Thus, funds with assets of at least \$50 billion would be nonexempt from registration, even if § 3(a)(2) were construed as exempting from registration all pension funds "maintained by a bank or in a separate account maintained by an insurance company." See SEC 35 Statistical Bulletin 552 (November, 1976).

The court's error is at least partially understandable since it got the idea from the SEC which argued in its brief that there is only one "affirmative condition" to exemption from registration under § 3(a)(2), that is, that a pension plan be qualified under Section 401 of the Internal Revenue Code and that 96% of all pension plans are so qualified. (SEC Br. 59, n.81, quoted at A. 258, n.61). The SEC was able to say this only by reading the additional condition "maintained by a bank" out of the statute, a rewriting of § 3(a)(2) which the court below was not prepared to swallow. Instead, the court inserted an unstated and absurd premise to the SEC's statistical conclusion: that pension fund qualification under the

Internal Revenue Code is the same as or co-extensive with bank maintenance of pension assets. (A. 258, n.61)<sup>103</sup>

Since the court below also erred in its description and interpretation of many details of the legislative history of the 1970 amendment and omitted others of significance, our exposition with respect to the amendment is unavoidably lengthy. Notwithstanding the length of the discourse, the 1970 amendment has nothing to do with the question presented.

b. *The Language of the 1970 Amendment.*

The 1970 amendment deals only with single and collective trust funds maintained by a bank or in separate accounts maintained by an insurance company; these it exempts from registration but not from the antifraud provisions of the federal securities laws. The amendment was drafted to deal only with the question of whether banks and insurance companies are required to register their sales of interests in trust funds or investment accounts which they maintain in connection with employee pension plans.<sup>104</sup> It does not address and therefore says nothing at all about the status of interests in the pension plan itself; that issue was not then considered. That this

<sup>103</sup> The court there says also: "Because of the longtime and consistent administrative practice, these pension funds might be deemed beyond the scope of the registration requirements even if they are not already exempted" (§ 302(a)). Passing the question of just what the SEC's practice was, the court's supposition invites the question as to what would be the statutory source of the SEC's authority to provide such an exemption. We know of none.

<sup>104</sup> While § 3(a)(2) also deals with separate accounts maintained by insurance companies and other types of qualified employee plans, for convenience and brevity we will hereafter refer to the exemption only as it relates to interests in trust funds maintained by banks and issued in connection with qualified pension plans.

interpretation and only this interpretation is correct appears from the language of the amendment to § 3(a)(2) which, in pertinent part, as amended, provides an exemption from registration for

"any interest or participation in a single or collective trust fund maintained by a bank or in a separate account maintained by an insurance company which interest or participation is issued in connection with (A) a stock bonus, pension, or profit-sharing plan which meets the requirements for qualification under section 401 of the Internal Revenue Code of 1954."<sup>105</sup>

The statute carefully distinguishes between a trust fund maintained by a bank and a pension plan. Interests in trust funds which are "maintained by a bank . . . in connection with" pension plans are exempted; but interests in the underlying pension plans are not dealt with. When a bank maintains a trust fund in connection with a pension plan, the interest in that fund is a security which

<sup>105</sup> We here set forth the entire text of the pertinent language added by the amendment:

"any interest or participation in a single or collective trust fund maintained by a bank or in a separate account maintained by an insurance company which interest or participation is issued in connection with (A) a stock bonus, pension, or profit-sharing plan which meets the requirements for qualification under section 401 of the Internal Revenue Code of 1954, or (B) an annuity plan which meets the requirements for the deduction of the employer's contribution under section 404(a)(2) of such Code, other than any plan described in clause (A) or (B) of this paragraph (i) the contributions under which are held in a single trust fund maintained by a bank or in a separate account maintained by an insurance company for a single employer and under which an amount in excess of the employer's contribution is allocated to the purchase of securities (other than interests or participations in the trust or separate account itself) issued by the employer or by any company directly or indirectly controlling, controlled by or under common control with the employer or (ii) which covers employees some or all of whom are employees within the meaning of section 401(c)(1) of such Code. \* \* \*"

the bank sells to its customer. The customer is the person or group who determines how the assets which fund the pension plan are to be invested. That may be the sponsor (the employer or other organization establishing the plan) or, in the case of an underlying pension trust, the trustee of that trust. In that situation there are two relationships: (1) that between the bank and its customers and (2) that between the sponsors or trustees of an underlying pension trust and the employees who are the plan participants; it is only the former which involves the "purchase and sale" of a "security." However under a long-standing SEC interpretation registration was not required for the sale of interests in the bank's trust fund on the rationale that the transaction did not involve any public offering and was therefore exempt under what is now Section 4(2) of the 1933 Act, a proposition which was not free from doubt. See Loss, *IV Securities Regulation*, 2538 (Supp. 1969).<sup>106</sup> The principal purpose of the 1970 amendment to § 3(a) (2) was to codify that administrative practice, and eliminate any questions with respect to whether or not such interests were required to be registered. That amendment, however, did not deal with what is at issue here, the status under the securities laws of employee interests in the underlying pension plans.

In its brief in the court below the SEC agreed that as the amendment to § 3(a) (2) of the 1933 Act passed the Senate in the 91st Congress its purpose "was to clarify the status of certain commingled investment accounts maintained by banks and insurance companies." (SEC

<sup>106</sup> "The Commission has consistently taken the position that the commingling of corporate pension plans and the operation of common trust funds involves the issuance of a security—although often in a transaction not involving a public offering." Memorandum re Securities Act Release No. 4552, Nov. 6, 1962. Reprinted in *Common Trust Funds—Overlapping Responsibilities and Conflict in Regulation*, Hearing Before a Subcommittee of House Committee on Government Operations, 88th Cong., 1st Sess., 167-168 (1963). See also Mundheim and Henderson p. 113, n. 98, *supra*, at pp. 820-821.

Br. 32). The Court of Appeals accepted the SEC's contention that the subsequent action of a House Subcommittee, which added the two words, "single or", "altered the focus of the exemption to encompass interests in the underlying pension funds." (A. 239) Our examination of what this change did to the text, and of the explanations in the Committee Reports and floor debate after these words were added will demonstrate that the focus never changed; it always remained exclusively on the interests in bank trust funds maintained for pension plans and never reached interests in the underlying pension plans. Before doing so, however, we shall briefly summarize the earlier history of the amendment. Against that background, the shift in focus which the Court of Appeals posits is seen to be an even more radical transformation of the original conception of the bill.

*c. The History of § 27(b) prior to the House Amendment.*

The dominant concerns of the 1970 Act were two major and controversial proposals to regulate mutual fund management fees and "front end load" commission charges.<sup>107</sup> These proposals had been the principal features of S. 1659 of the 90th Congress which, as originally introduced, in May 1967, contained only proposed amendments to the Investment Company Act of 1940 and the Investment Advisors Act of 1940. In November 1967 Senator McIntyre introduced Amendment 438 which added a new Title II to S. 1659. Title II included proposed amendments to the federal banking and securities laws relating to three types of bank collective investment funds: (1) collective investment funds for managing agency accounts (so-called "bank mutual funds"); (2) assets held by a bank in a fiduciary capacity, such as trustee, executor, administra-

<sup>107</sup> *Mutual Fund Legislation of 1967*, Hearings before the Senate Committee on Banking and Currency, 90th Cong., 1st Sess., on S. 1659, 23 (hereafter "1967 Hearings").

tor or guardian; and (3) bank collective trust funds consisting of assets of qualified employee pension trusts, including H.R. 10 retirement plans for self-employed individuals.<sup>108</sup>

Sen. McIntyre's proposals with respect to two types of bank collective funds, those held in a fiduciary capacity and those held for employee pension plans were non-controversial and characterized as consistent with existing SEC interpretations.<sup>109</sup> As to bank trust funds maintained for pension plans, an SEC Analysis stated:

"The amendments expressly exempt from the registration provisions of the Securities Act and Section 12(g) of the Exchange Act "any collective fund maintained by a bank consisting solely of assets of retirement, pension, profit-sharing, stock bonus or other trusts which are exempt from federal income taxation under the Internal Revenue Code" except any fund consisting of assets from H.R. 10 plans.

<sup>108</sup> See the analysis of the amendment prepared by the SEC. 1967 Hearings, Part 3, 1209, 1221-1222.

Earlier versions of these proposals were contained in the proposed Bank Collective Investment Fund Acts of 1963 and 1965. See Collective Investment Funds, Hearings Before a Subcommittee of House Committee on Interstate and Foreign Commerce, H.R. 8499, H.R. 9410, 88th Cong., 2d Sess. (1964); Collective Investment Funds, Hearings Before a Subcommittee of Senate Committee on Banking and Currency on S.2704, 89th Cong., 2d Sess. (1966). See also Common Trust Funds—Overlapping Responsibilities and Conflict in Regulation, Hearing Before a Subcommittee of House Committee on Government Operations, 88th Cong., 1st Sess. (1963). The history which gave rise to these proposals is summarized in Loss, IV *Securities Regulation*, 2536-2549 (1969 Supp.) and Mundheim and Henderson, op. cit. p. 113, n. 98, *supra*, at 795, 819-833.

<sup>109</sup> The third proposal in Amendment 438, to expressly permit banks to operate commingled investment funds for individual agency accounts in direct competition with mutual funds, was highly controversial and was ultimately left by the 1970 Act to then existing law. Investment Company Amendments Act of 1970, H. Conf. Rep. No. 91-1631, 28-29. The issue was ultimately resolved against the banks in *Investment Company Institute v. Camp*, 401 U.S. 617.

The amendment is consistent with SEC practice under existing law except insofar as the exemption may extend to funds which invest in the employer's stock and include employee contributions." 1967 Senate Hearings, 1222.

The SEC shortly thereafter decided that the scope of the proposed exemption presented no problem with respect to contributory plans which invest in the employer's stock. In a Memorandum to the Senate Committee the SEC said:

"In testimony before the Senate Committee, the Chairman expressed reservations about the proposed amendment insofar as it would provide an exemption for corporate pension plans which invest in the employer's stock. Such an exemption would be contrary to the established position of the Commission which requires registration of those plans which invest substantially in the employer's stock.

. . . . .

"The Commission, however, does not believe it is necessary to recommend changes in the proposed amendments to deal with employee plans which invest in the employer's stock, since *the language of the amendment clearly indicates that it would exempt from registration only interests in the collective funds for corporate pension plans and not interests in the plans themselves*. Thus, the legislation will not affect the Commission's existing authority to require Securities Act registration for interests in corporate pension plans which are funded by bank collective funds, even though interests in the funds are exempt from registration . . ." (*Id.* at 1341-1342) (emphasis added)

Thus the SEC recognized the distinction between interests in bank trust funds holding pension fund assets and interests in the underlying plans. The SEC also recognized that the proposed amendment to Section 3(a)(2) of the 1933 Act dealt with the former but not the latter.

The McIntyre Amendment was included in S. 3724 which was favorably reported by the Senate Committee in July 1968, and passed the Senate in 1968. However, the House failed to act. In January 1969 Senator Sparkman introduced S. 34 which was drawn from S. 3724 and the substance of which was reported favorably as S. 2224 by the Senate Committee on Banking and Currency after hearings held in April 1969.<sup>110</sup>

Section 27(b) of S. 2224 which contained the amendment to Section 3(a)(2) of the 1933 Act was included in Part B of the bill, a group of provisions relating to "Banks and Savings and Loan Associations and Insurance Companies," 1969 Senate Report, 22. The Report explained the pertinent part of Section 27(b) as follows:

"The amendment would also exempt from the registration provisions of the act interests or participations in collective trust funds maintained by banks for funding certain stock bonus, pension, or profit-sharing plans which meet the requirements for qualification under section 401(a) of the Internal Revenue Code. In effect, the amendment would exempt interests or participations in connection with corporate pension or profit-sharing plans which meet the requirements for qualification under section 401(a) of the code, but not interests or participations in connection with such plans (known as "H.R. 10 plans") which cover employees, some or all of whom are employees within the meaning of section 401(c)(1) of the code. *The exemption is limited to interests or participations in those bank collective trust funds maintained for the funding of employees' stock bonus, pension, or profit sharing plans and not as vehicles*

<sup>110</sup> S. Rep. No. 91-184, 91st Cong., 1st Sess., Investment Company Amendments Act of 1969 (the "1969 Senate Report").

*for direct investment by individual members of the public."*<sup>111</sup>

The distinction between interests in bank trust funds holding assets used to fund pension plans and interests in the underlying pension plans was thus still clear.

d. *The Addition of "single or" by the House, the Resulting Language, the House Committee Report and the Explanatory Colloquy.*

The text of the amendment as the bill passed the Senate was that quoted at A. 239 and, as the court acknowledges, the amendment was solely addressed to interests in bank trust funds. But the language which so demonstrated was not the word "collective" (emphasized *id.*), but the phrase "maintained by a bank".

It is at this point, according to the Court of Appeals, that the House Subcommittee's addition of the words "single or" to precede the phrase "collective trust funds maintained by a bank" "altered the focus of the exemption to encompass interests in the underlying pension funds" A. 239. The words of the amendment as thus changed, the explanation therefor given in Congress, and subsequent developments before passage, all refute the Court of Appeals' interpretation.

We begin, of course, with the language of the amendment. (*Ernst & Ernst v. Hochfelder*, *supra* 425 U.S. at 200). With the addition of the words "single or", the phrase in question read "any interest or participation in a single or collective trust fund maintained by a bank . . . which interest or participation is issued in connection with . . . a . . . pension . . . plan." The distinction between a bank trust fund and an underlying pension

<sup>111</sup> 1969 Senate Report at 27 (emphasis supplied). This was the identical explanation given in the Senate Report in the prior Congress reporting favorably on the McIntyre Amendment, S. Rep. No. 90-1351, 90th Cong., 1st Sess., 25-26.

plan remained clear as it had since the McIntyre amendment was introduced in 1967. With the addition of the words "single or" the amendment still exempted only interests in a bank trust fund and not interests in the underlying pension plan.

The Court of Appeals confuses the words "funds" and "plans." It refers to "pension funds" and "pension plans" interchangeably, A. 236-242, although Congress was more precise. The amendment consistently differentiates between "pension plans" and "trust funds", be they single or collective; the phrase "pension fund" nowhere appears. And the Commission itself had been equally precise when it described an earlier version of the amendment in its 1967 memorandum, quoted at p. 123, *supra*.

With the words so clear, resort to legislative history should be unnecessary. But that history abundantly demonstrates that the change in focus found by the court never took place.

It is reasonable to suppose that if the subcommittee thought it had made a significant change in the bill by adding "single or", its Report to the full House would have so stated. Yet, that Report did not even mention the addition of the two words, to which the court attributes such far-reaching effect. Its explanation of the bill was word for word the same as that of the Senate Committee prior to the change.<sup>112</sup>

But we need not rely on inference. For the meaning of the change from the Senate bill was the subject of a colloquy in the House debate between Congressman Springer, the ranking minority member and Congressman Moss, the chairman of the subcommittee:

Mr. SPRINGER. The second question: Section 27 (b) of the bill provides an exemption from registration

<sup>112</sup> H.R. Rep. No. 91-1382, 91st Cong., 2d Sess., 43. Compare the 1969 Senate Report, quoted at pp. 124-125, *supra*.

under the Securities Act of 1933 for interests or participations in trust funds maintained by banks for funding certain stock bonus, pension or profit-sharing plans which meet the requirements for qualification under section 401 of the Internal Revenue Code. I understand that this bill differs slightly from the bill passed by the Senate in that it would make it clear that interests in a single trust maintained by a bank where the trust assets were not commingled with those of other qualified trusts would also be exempted from the registration requirements of the Securities Act. I understand that the SEC has required registration of interests and participations in such trust funds where employee money is used to buy securities of the employer or companies affiliated with the employer. I understand that this bill would not prevent the SEC from requiring registration of interests or participations in such trusts if that also were the case. Am I correct?

Mr. MOSS. The gentleman is correct. It is my understanding that that is what was intended.

Mr. SPRINGER. I thank the distinguished gentleman for his explanation.<sup>113</sup>

This deliberate and authoritative colloquy, far from stating that there had been a significant change in "focus", declared that the House bill differed from the Senate bill "slightly", in that "a single trust maintained by a bank where the trust assets were *not* commingled with those of other qualified trusts would *also* be exempted from registration" under the securities laws; that is, they would be treated like "collective trusts maintained by a bank" under the Senate bill.<sup>114</sup>

<sup>113</sup> 116 Cong. Rec. 33287 (Sept. 23, 1970).

<sup>114</sup> The court states that the House subcommittee added the words "single or" in response to the letter of Stannard Dunn, General Counsel for Sperry Rand Corporation (A. 239). The Court of Appeals quoted the language which Mr. Dunn suggested be added to

This colloquy, which is not discussed by the court below, is independently conclusive against the court's interpretation of the 1970 amendment. Only by ignoring or misreading this colloquy could the court assert that "Thus" the "focus" of the exemption provision was altered

§ 27(b), *id.* but overlooked the significance of the subcommittee's refusal to accept his suggestion. The second paragraph of Mr. Dunn's letter pointed out that § 27(b) as it then stood would exempt only interests in "common" or "collective" trust funds maintained by banks in connection with employee benefit plans, but failed

"to exempt interests or participations in a similar, and commonly used, type of employee benefit plan—that is, a plan under which funds are paid to a bank trustee that invests them in its discretion (without comingling [*sic*] with other trust funds in a 'common' or 'collective' trust fund) . . ."

Hearings before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce, 91st Cong., 1st Sess., on H.R. 11995, at 929. Mr. Dunn's letter went on to point out that the SEC had long taken the position in "no action" letters that registration would not be required for contributory employee plans so long as employee contributions were not invested in employer securities. He stated that this had not been a "satisfactory treatment of the problem" because such Commission advice "does not purport to exempt the interests or participations from any registration requirement nor to afford legal protection against civil suits under the Securities Act or actions under state 'blue sky' laws." The letter concluded by suggesting the addition of a separate clause in § 3(a)(2) which would exempt any interest or participation "in any employees' stock bonus, pension or profit-sharing trust . . . which meets the requirements . . . of Section 401 of the Internal Revenue Code." *Id.* 930, 931.

The adoption of this portion of Mr. Dunn's proposal would indeed have vastly broadened the focus of the amendment since it would have dealt separately with interests in employee benefit plans themselves. But the House Committee did not adopt it, as the language it chose and the Springer-Moss colloquy make clear. In refusing to adopt the additional exemption proposed by Mr. Dunn and modifying § 27(b) only to exempt single as well as collective trust funds maintained by banks in connection with employee pension plans, the House subcommittee showed its intention not to broaden the scope of the amendment beyond that which it had since it was first introduced in 1967.

"to encompass interests in the underlying pension funds." A. 239.

The Conference Committee accepted the House version of § 27(b).<sup>115</sup> The entire statement by the Conference Committee on § 27(b), as modified by the House, was as follows:

"Exemptions from Registration Under the  
Securities Act of 1933 for  
Certain Trust Accounts

"The Senate bill exempted from the registration requirements of the 1933 Act certain collective trust funds maintained by a bank or in a separate account maintained by an insurance company.

"The House amendment would have codified a long established administrative practice of the Commission by making it clear that this exemption applied not only to collective trust funds, but also to single trust funds.

"The conference agreement follows the House version."<sup>116</sup>

e. Which Administrative Practice Was Codified?

The Court of Appeals opined that the administrative view which was codified by the 1970 amendment was that "although interests in pension funds did not need to be registered in most cases, they are nonetheless securities." (A. 241). Its citation of the Springer-Moss colloquy (pp. 126-127, *supra*) for that proposition is inexplicable.<sup>117</sup> The

<sup>115</sup> It adopted a further change described at pp. 130-131, *infra*.

<sup>116</sup> H. Conf. Rep. 91-1631, 91st Cong., 2d Sess., 31 (1970).

<sup>117</sup> The SEC for its part did not rely on the colloquy; indeed it failed even to call it to the court's attention, although it was obviously the most direct and authoritative explanation of the amendment on which the SEC based its argument.

only administrative practice which Mr. Springer mentioned is one with respect to bank-maintained trust funds "where employee money is used to buy securities of the employer . . ." which, of course, is not relevant here. And the administrative practice which the Conference Report said was codified by the *House Amendment* was that the registration exemption of bank-maintained trust funds, "applied not only to collective trust funds, but also to single trust funds."

It is clear from its language and history that the principal administrative practice which was codified by the 1970 amendment was not one relating to pension plans but rather the SEC practice of exempting sales of interests in bank trust funds operated for pension plans on the ground that no public offering was involved. *Supra*, p. 120. It is the same administrative practice to which the SEC memorandum had referred in 1967, before "single or" was added. That addition thus merely perfected the original intention to codify the Commission's practice with respect to sales of interests in such bank trust funds, whether commingled or not.

f. *The Subsequent Changes.*

Two changes were made in § 27(b) subsequent to the House amendment but neither of those changes showed any "shift to include interests in the underlying plans." (A. 240). The first change was made by the Conference Committee. It added a new clause (i) which contained an exception to the basic exemption from registration accomplished by the amendment.<sup>118</sup> This is the change referred to at A. 240-241 relating to certain types of contributory plans. But the court's explanation is erroneous. The true meaning of clause (i) can best be understood in

<sup>118</sup> Another exception, which was preserved as clause (ii), deals with H.R. 10 plans.

conjunction with the further changes which were made a few days later.

After the House Committee added and the Conference Committee approved the addition of the words "single or", concern was expressed (notwithstanding Congressman Springer's assurance) that this change might have created a loophole through which contributory plans which invested employee money in the employer's securities and which had always been required to register might have been able to escape registration. The possibility existed because such a plan might designate a bank as trustee, provide for separate administration of its fund (hence a "single fund") and argue that since a bank was the issuer of interests in the fund, the exemption applied and registration was not required. The Conference Committee decided to deal with the problem by adding an express exception as clause (i). However, that first effort at drafting clause (i) went too far since it would also have required a bank trustee to register any interests in a *collective* fund which were sold to a contributory plan of the type traditionally required to register and this would have defeated one of the major objectives of § 27(b). Senator Sparkman cured this difficulty by a further amendment (tacked on to another pending bill) which narrowed the exception in clause (i).<sup>119</sup>

<sup>119</sup> Pub. L. 91-567, § 6, 84 Stat. 1497. The Sparkman amendment added the words italicized in the following text and eliminated the words in brackets:

"(i) *the contributions under which are held in a single trust fund maintained by a bank or in a separate account maintained by an insurance company for a single employer and under which an amount in excess of the employer's contribution [for any period] is allocated to the purchase of securities (other than interests or participations in the trust or separate account itself) issued by the employer or by any company directly or indirectly controlling, controlled by or under common control with the employer . . .*"

Clause (i) only describes those cases in which a bank is required to register interests in trust funds which it maintains. The Court of Appeals appears to read clause (i) as if it was intended to describe all instances in which contributory plans are required to register (A. 240-241). This is clearly incorrect since it would allow a contributory plan which invests employee contributions in employer securities and the balance of its assets in a bank collective trust fund to escape registration on the ground that it is not described in clause (i). Similarly, such a contributory plan is still required to register even though it does not invest in any bank trust fund and is not described in clause (i) or § 3(a)(2) itself.

The Court of Appeals ignored the first change made by the Sparkman amendment, the language added at the beginning of clause (i). We have explained the reason for that change, *supra*, at p. 131. The Court of Appeals mentioned only the second change in the Sparkman amendment, the addition of the parenthetical exclusion, but described it incorrectly as an amendment "to make it clear that the term 'security issued by the employer' did not include the securities consisting of the interests in the pension fund." (A. 241). The parenthetical exclusion however does not refer to interests in "the pension fund" but to "interests . . . in the trust" and the only trusts mentioned in clause (i) are those maintained by a bank. The parenthetical exclusion was apparently intended to deal with those situations in which assets funding a pension plan maintained by a bank or insurance company for its own employees are invested in the bank's own trust fund or a separate account of that insurance company. In such cases interests in the trust fund or separate account could have been regarded as securities issued by the employer, but they were not the type whose purchase with employee contributions was intended to require registration.

In the court below, the SEC argued that under its interpretation of the 1970 amendment all pension plans which are qualified under § 401 of the Internal Revenue Code would be exempt from registration, a figure which it estimated at 96% of all plans. This interpretation of the 1970 amendment ignores its language which restricts the exemption to funds "maintained by a bank or in a separate account maintained by an insurance company . . ." The Court of Appeals did not repeat this error. Without expressly noting its disagreement with the SEC, it placed a narrower interpretation on the amendment, namely that its effect was to exempt pension funds which are "being maintained by a bank." (A. 236). While this version at least addresses the language of the amendment, it raises very serious difficulties of its own. It attributes to Congress an intention, nowhere mentioned in the legislative history, to radically narrow the existing administrative practice under which most pension plans were not required to register, so that the statutory exemption said to codify that practice would apply only to pension plans maintained by banks and insurance companies. The practical consequences of such a step would be very large. The percentage of plans whose assets are not maintained either by a bank or a separate account maintained by an insurance company is very substantial. (See the SEC statistics discussed at p. 117 *supra*.) Under the Court of Appeals' view, these plans would be subject to the registration as well as the anti-fraud provisions of the securities laws.

The Court of Appeals nowhere attempts to explain why Congress should have chosen to create two classes of pension plans—those maintained by banks and insurance companies and those which are not—and exempted the former but not the latter from registration. Moreover, since the Court of Appeals' theory was that Congress was codifying an SEC administrative practice, it is significant that the SEC did not even argue, let alone establish, that

it ever administratively differentiated between pension funds which are "maintained by a bank . . ." and other pension funds, with respect to registration or otherwise. Thus, the SEC's interpretation is irreconcilable with the statutory language, and the Court of Appeals' version attributes to Congress the intent to codify an administrative practice whose existence no one has ever suggested.

Only petitioners' interpretation of the 1970 amendment avoids both horns of this dilemma. It explains the reference to administrative practice in the Conference Report and, more conclusively, it explains why Congress used the phrase "maintained by a bank."<sup>120</sup> On the other hand, since as of 1970, neither the SEC nor anyone else had held that there is a sale of a security when an individual accepts or continues employment where there is a mandatory, non-contributory pension plan, there was no perceived reason to codify the general understanding that such plans are not covered by the securities laws at all, including the registration provisions of the 1933 Act.

At least as late as 1971, in the Institutional Investor Study, the SEC was taking the position that the entire 1933 Act, rather than just its registration requirement, was inapplicable to mandatory non-contributory pension plans, *supra*, pp. 59-60. The argument that in 1970 Congress had codified an administrative view that the antifraud provisions were applicable to such plans cannot be squared with this evidence.

The Court of Appeals' interpretation of the 1970 amendment is on its face a grave indictment of the legislative process. It is not a light thing to suggest that

<sup>120</sup> As we have seen, this was done at the behest of the banks in order to codify the administrative interpretation that they were not required to register their sale of interests in trust funds which they maintained for pension plans.

Congress casually shifted the "focus" of a proposal "to clarify the status of certain commingled investment accounts maintained by banks and insurance companies" (SEC Br. 32) into a sweeping determination that interests in all pension plans should be deemed securities and subject to the antifraud provisions of the securities laws and, in the case of plans not maintained by banks or insurance companies, subject also to the registration provisions of those laws. It is likewise a startling suggestion that Congress did so, as the Court of Appeals asserts, on the basis of a single letter from the counsel for one corporation, without hearing from other companies, or from labor organizations, pension plan administrators and others which would be affected thereby and without any other study of the consequences of such a profound expansion. And it stretches credulity to maintain that Congress would take such a giant step without at the very least stating in a committee or conference report or authoritative floor debate that that is what it has done. Of course, as we have seen, the evidence establishes conclusively that Congress did not perpetrate the travesty of the legislative process which the Court of Appeals tacitly found.

#### IV. ANY APPLICATION OF THE DISCLOSURE REQUIREMENTS OF THE SECURITIES LAWS SHOULD BE PROSPECTIVE ONLY, BECAUSE "RETROACTIVE LIABILITY COULD BE DEVASTATING FOR A PENSION FUND."

If it were held that Mr. Daniel and other participants in involuntary non-contributory pension plans are "purchasers" of a "security," the financial impact upon such plans and their beneficiaries would be enormous. While the opinion below is unenlightening as to the standards that would govern pension plans' antifraud liability and specifically avoids consideration of the relief to be granted

in the event of liability,<sup>121</sup> it is evident that there would be innumerable potential plaintiffs with colorable complaints about their plans' failure to make various disclosures previously deemed unnecessary. If even a tiny fraction of these potential plaintiffs were awarded previously denied pensions as plaintiff maintains they should (or received the amount of past contributions with respect to their employment), the solvency of such plans and their ability to pay prescribed benefits would be drastically jeopardized.

The situation would then be essentially that dealt with in *Los Angeles Dept. of Water & Power v. Manhart*, No. 76-1810 (April 25, 1978), which affirmed an alteration of previously accepted principles of pension management in another respect—by holding that Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e-2(a)(1), prohibits pension contribution requirements for women higher than those for men notwithstanding different mortality rates. The Court held that the courts below should not have awarded retroactive monetary relief because:

"Although we now have no doubt about the application of the statute in this case, we must recognize that conscientious and intelligent administrators of pension funds, who did not have the benefit of the extensive briefs and arguments presented to us, may well have assumed that [such] a program \* \* \* was entirely lawful. The courts had been silent on the question, and the administrative agencies had conflicting views." (Slip op. pp. 16-17)

<sup>121</sup> The only guidance offered to plan administrators is that "all material facts are [to be] disclosed in a manner comprehensible to the average worker" (A. 259). While acknowledging the "not uncomplicated question of the form of relief," the Court of Appeals simply stated that: "It is for the district court to construct a remedy which properly balances the needs of plaintiff against those of other fund participants" (A. 257).

The Court then went on to consider:

"\* \* \* the potential impact which changes in rules affecting insurance and pension plans may have on the economy \* \* \*. These plans, like other forms of insurance, depend on the accumulation of large sums to cover contingencies. The amounts set aside are determined by a painstaking assessment of the insurer's likely liability. Risks that the insurer foresees will be included in the calculation of liability, and the rates or contributions charged will reflect that calculation. The occurrence of major unforeseen contingencies, however, jeopardizes the insurer's solvency and, ultimately, the insureds' benefits. Drastic changes in the legal rules governing pension and insurance funds, like other unforeseen events, can have this effect. Consequently, the rules that apply to these funds should not be applied retroactively unless the legislature has plainly commanded that result." (Slip op. p. 18.)

Here, as in *Manhart*, "this is apparently the first litigation" asserting the rule of pension management adopted below, and that rule would "represent[] a marked departure from past practice." Slip op. p. 19; see Point III, *supra*. "Retroactive liability could be devastating for a pension fund" and "[t]he harm would fall in large part on innocent third parties" (slip op. p. 19), pensioners and current employees who (on the theory followed below) indirectly finance the pension funds. Thus, precisely the same policy and practical considerations militate here also in favor of treating any such rule as only a standard for behavior henceforth and not as a basis for monetary recovery.<sup>122</sup> Treatment of the securities laws is-

<sup>122</sup> Moreover in this case, unlike *Manhart*, non-retroactivity of newly announced legal rules would not necessarily deny plaintiff all opportunity for monetary relief. The complaint includes alternate claims, including a claim under § 302(c)(5) of the Taft-Hartley Act, 29 U.S.C. § 186(c)(5), which has been held to provide relief from pension eligibility requirements such as those about which

sue under review must, moreover, accord with the principle, followed in *Manhart*, that the Court "cannot base a ruling on the facts of this case alone" but must consider the effect of retroactivity *vel non* upon the generality of pension plans to which it would apply. Slip op. p. 19, n.42.<sup>123</sup>

*Manhart* denied retroactive recovery although this Court had held that in suits under Title VII there is a "presumption in favor of retroactive liability [which] can seldom be overcome." (Slip op. p. 16 citing *Albemarle Paper Co. v. Moody*, 422 U.S. 405; See also slip op. p. 20). Thus the Court necessarily found prevention of such pension plan dislocations a matter of unusual public policy significance, as indeed its language itself indicates. Such "considerations of policy" have even more force where the granting of *any* private remedy is due only to a "judicially implied cause of action" (*Blue Chip*, 421 U.S. at 736). As the Court there said:

"It is therefore proper that we consider \* \* \* what may be described as policy considerations when we come to flesh out the portions of the law with respect to which neither the congressional enactment nor the administrative regulations offer conclusive guidance." (*Id.* at 737)

plaintiff principally complains insofar as they are "arbitrary and capricious." *Johnson v. Botica*, 537 F.2d 930, 933-934 (C.A. 7); *Burroughs v. Board of Trustees*, 542 F.2d 1128 (C.A. 9), cert. denied, 429 U.S. 1096. (See A. 212, n.3).

<sup>123</sup> In *Manhart* the Court was properly unmoved by arguments, similar to those advanced in the opinion below (A. 257-258), seeking to minimize the impact of changes in pension rules. See slip op. pp. 19-20, nn. 42 & 43. Similarly, the court of appeals' general comments about the factual showing that plaintiffs would have to make (A. 259) offer little comfort in view of the plain fact that pension managers have never deemed it necessary to make actuarial or other securities-type disclosures to employees covered by involuntary non-contributory plans. In any event, these factual issues would ordinarily require full litigation, with all of the expenses that would entail even if the outcome were not adverse to the pension plan.

"We are dealing with a private cause of action which has been judicially found to exist, and which will have to be judicially delimited one way or the other unless and until Congress addresses the question." (*Id.* at 749)

The "delimitation" made in *Blue Chip* precluded suits by persons other than literal "purchasers" and "sellers" of securities. The "policy considerations" upon which the Court relied included "the danger of vexatious litigation" (*id.* at 740), unduly disrupting normal business activities, involving "many rather hazy issues of historical fact the proof of which [would depend] almost entirely on oral testimony" (*id.* at 743), and risking "a liability in an indeterminate amount for an indeterminate time to an indeterminate class" (*id.* at 748, quoting from *Ultramares Corp. v. Touche*, 255 N.Y. 170, 179-180, 174 N.E. 441, 444 (1931)). These same policy considerations are present in this case and they argue against the creation of any securities law remedy at all. When the more specific pension policies that were decisive in *Manhart* are added, the case for non-retroactive liability is conclusive. Indeed, it would be enough that this is an unusually compelling situation for application of the general doctrine that a decision on "an issue of first impression whose resolution was not clearly foreshadowed" is appropriately non-retroactive where it "could produce substantial inequitable results if applied retroactively." (*Chevron Oil Co. v. Huson*, 404 U.S. 97, 106-107.)

The inequity of imposing financial liability under the securities laws for noncompliance with disclosure standards that were generally understood to be non-existent is well articulated in Judge Friendly's opinion for the court in *Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1291-1294 (C.A. 2):

"[W]e would be loath to impose a huge liability \* \* \* on the basis of what we regard as a substantial

modification, if not reversal of the SEC's position on disclosure \* \* \*, by way of its *amicus* brief in this case." (*Id.* at 1294)

*Mutatis mutandis*, that is exactly what the SEC successfully did in its *amicus* brief in the court below.

In *Manhart* the Court noted that in enacting ERISA Congress "underlined the importance of making only gradual and prospective changes in the rules that govern pension plans." Slip op. p. 18, n.40. Such reference to related legislation as a major source of the "policy considerations" to be applied by the courts is even more appropriate in the present context, where the applicable law is itself a judicial creation. "It has always been the duty of the common-law court to perceive the impact of major legislative innovations and to interweave the new legislative policies with the inherited body of common-law principles \* \* \*" *Moragne v. States Marine Lines, Inc.*, 398 U.S. 375, 392. Even if the general substantive policies embodied in ERISA were not deemed inconsistent with judicial creation of additional pension requirements based upon the securities laws, this specific Congressional policy against dislocation of existing pension systems would at the least command that any such additional remedy be prospective only.

## CONCLUSION

For the foregoing reasons, the judgment of the court below should be reversed and the case remanded with direction to the District Court to dismiss Counts I and II of the complaint.

Respectfully submitted,

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# APPENDIX

1a

## APPENDIX

### STATUTES AND RULE INVOLVED

This case involves §§ 2(1), 2(3), 3(a)(2), and 17(a) of the Securities Act of 1933, 48 Stat. 74 as amended (15 U.S.C. §§ 77a *et seq.*); §§ 3(a)(10) and 10(b) of the Securities Exchange Act of 1934, 48 Stat. 881 as amended (15 U.S.C. §§ 78a *et seq.*) and SEC Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5; §§ 9(a) and 302(c)(5) of the National Labor Relations Act of 1935, as amended by the Labor Management Relations Act of 1947, etc., 49 Stat. 449, 61 Stat. 136, 73 Stat. 519 (29 U.S.C. §§ 141 *et seq.*) and §§ 102 and 3004 of the Employment Retirement Income Security Act of 1974, 88 Stat. 832 (29 U.S.C. §§ 1001 *et seq.*).

Section 2(1) of the Securities Act of 1933 (15 U.S.C. § 77b(1)) provides:

When used in this subchapter, unless the context otherwise requires—

(1) The term “security” means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a “security,” or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Section 2(3) of the Securities Act of 1933 (15 U.S.C. § 77b(3)) provides as pertinent:

The term "sale" or "sell" shall include every contract of sale or disposition of a security or interest in a security, for value. \* \* \*

Section 3(a)(2) of the Securities Act of 1933 (15 U.S.C. § 77c(a)(2)) as originally enacted provided:

(a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities:

\* \* \* \*

(2) *Any security issued or guaranteed by the United States or any Territory thereof, or by the District of Columbia, or by any State of the United States, or by any political subdivision of a State or Territory, or by any public instrumentality of one or more States or Territories exercising an essential governmental function, or by any corporation created and controlled or supervised by and acting as an instrumentality of the Government of the United States pursuant to authority granted by the Congress of the United States, or by any national bank, or by any banking institution organized under the laws of any State or Territory, the business of which is substantially confined to banking and is supervised by the State or territorial banking commission or similar official; or any security issued by or representing an interest in or a direct obligation of a Federal Reserve bank.*

Section 17(a) of the Securities Act of 1933 (15 U.S.C. § 77q(a)) provides:

It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Section 3(a)(2) of the Securities Act of 1933 (as amended in 1970), (15 U.S.C. 77c(a)(2)), reads as follows:

"(2) Any security issued or guaranteed by the United States or any territory thereof, or by the District of Columbia, or by any State of the United States, or by any political subdivision of a State or territory, or by any public instrumentality of one or more States or territories, or by any person controlled or supervised by and acting as an instrumentality of the Government of the United States pursuant to authority granted by the Congress of the United States; or any certificate of deposit for any of the foregoing; or any security issued or guaranteed by any bank; or any security issued by or representing an interest in or a direct obligation of

a Federal Reserve bank; or any interest or participation in any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator, or guardian; \* \* \* or any interest or participation in a single or collective trust fund maintained by a bank or in a separate account maintained by an insurance company which interest or participation is issued in connection with (A) a stock bonus, pension, or profit-sharing plan which meets the requirements for qualification under section 401 of the Internal Revenue Code of 1954, or (B) an annuity plan which meets the requirements for the deduction of the employer's contribution under section 404(a)(2) of such Code, other than any plan described in clause (A) or (B) of this paragraph (i) the contributions under which are held in a single trust fund maintained by a bank or in a separate account maintained by an insurance company for a single employer and under which an amount in excess of the employer's contribution is allocated to the purchase of securities (other than interests or participations in the trust or separate account itself) issued by the employer or by any company directly or indirectly controlling, controlled by or under common control with the employer or (ii) which covers employees some or all of whom are employees within the meaning of section 401(c)(1) of such Code. The Commission, by rules and regulations or order, shall exempt from the provisions of section 5 of this title any interest or participation issued in connection with a stock bonus, pension, profit-sharing, or annuity plan which covers employees some or all of whom

are employees within the meaning of section 401(c)(1) of the Internal Revenue Code of 1954, if and to the extent that the Commission determines this to be necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this subchapter. For the purposes of this paragraph, a security issued or guaranteed by a bank shall not include any interest or participation in any collective trust fund maintained by a bank; and the term 'bank' means any national bank, or any banking institution organized under the laws of any State, territory, or the District of Columbia, the business of which is substantially confined to banking and is supervised by the State or territorial banking commission or similar official; except that in the case of a common trust fund or similar fund, or a collective trust fund, the term 'bank' has the same meaning as in the Investment Company Act of 1940."

Section 3(a)(10) of the Securities Exchange Act of 1934 (15 U.S.C. § 78c(a)(10)) provides:

When used in this chapter, unless the context otherwise requires—

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, tempo-

rary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)) provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

\* \* \*

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5 (17 C.F.R. § 240.10b-5) provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact nec-

essary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Section 9(a) of the National Labor Relations Act of 1935, as amended by the Labor Management Relations Act of 1934 (29 U.S.C. § 159(a)) provides:

(a) Representatives designated or selected for the purposes of collective bargaining by the majority of the employees in a unit appropriate for such purposes, shall be the exclusive representatives of all the employees in such unit for the purposes of collective bargaining in respect to rates of pay, wages, hours of employment, or other conditions of employment: *Provided*, That any individual employee or a group of employees shall have the right at any time to present grievances to their employer and to have such grievances adjusted, without the intervention of the bargaining representative, as long as the adjustment is not inconsistent with the terms of a collective-bargaining contract or agreement then in effect: *Provided further*, That the bargaining representative has been given opportunity to be present at such adjustment.

Section 302(c) (5) of the National Labor Relations Act of 1935, as amended by the Labor Management Relations Act of 1934 (29 U.S.C. § 186(c) (5)) provides:

(c) The provisions of this section shall not be applicable

\* \* \*

(5) with respect to money or other thing of value paid to a trust fund established by such representative, for the sole and exclusive benefit of the employees of such employer, and their families and dependents (or of such employees, families, and dependents jointly with the employees of other employers making similar payments, and their families and dependents): *Provided*, That (A) such payments are held in trust for the purpose of paying, either from principal or income or both, for the benefit of employees, their families and dependents, for medical or hospital care, pensions on retirement or death of employees, compensation for injuries or illness resulting from occupational activity or insurance to provide any of the foregoing, or unemployment benefits or life insurance, disability and sickness insurance, or accident insurance; (B) the detailed basis on which such payments are to be made is specified in a written agreement with the employer, and employees and employers are equally represented in the administration of such fund, together with such neutral persons as the representatives of the employers and the representatives of employees may agree upon and in the event the employer and employee groups deadlock on the administration of such fund and there are no neutral persons empowered to break such deadlock, such agreement provides that the two groups shall agree on an impartial umpire to decide such dispute, or in event of their failure to agree within a reasonable length of time, an impartial umpire to decide such dispute shall, on petition of either group, be appointed by the district court of the United States for the district where the trust fund has its principal office, and shall also contain provi-

sions for an annual audit of the trust fund, a statement of the results of which shall be available for inspection by interested persons at the principal office of the trust fund and at such other places as may be designated in such written agreement; and (C) such payments as are intended to be used for the purpose of providing pensions or annuities for employees are made to a separate trust which provides that the funds held therein cannot be used for any purpose other than paying such pensions or annuities; \* \* \*

Section 102 of the Employment Retirement Income Security Act of 1974 (29 U.S.C. § 1022) provides:

(a) (1) A summary plan description of any employee benefit plan shall be furnished to participants and beneficiaries as provided in section 1024(b) of this title. The summary plan description shall include the information described in subsection (b) of this section, shall be written in a manner calculated to be understood by the average plan participant, and shall be sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of their rights and obligations under the plan. A summary of any material modification in the terms of the plan and any change in the information required under subsection (b) of this section shall be written in a manner calculated to be understood by the average plan participant and shall be furnished in accordance with section 1024(b) (1) of this title.

(2) A plan description (containing the information required by subsection (b) of this section) of any employee benefit plan shall be prepared on forms prescribed by the Secretary, and shall be filed with the Secretary as required by section 1024(a) (1) of this title. Any material modification in the terms of the plan and any change in the information described

in subsection (b) of this section shall be filed in accordance with section 1024(a)(1)(D) of this title.

(b) The plan description and summary plan description shall contain the following information: The name and type of administration of the plan; the name and address of the person designated as agent for the service of legal process, if such person is not the administrator; the name and address of the administrator; names, titles, and addresses of any trustee or trustees (if they are persons different from the administrator); a description of the relevant provisions of any applicable collective bargaining agreement; the plan's requirements respecting eligibility for participation and benefits; a description of the provisions providing for nonforfeitable pension benefits; circumstances which may result in disqualification, ineligibility, or denial or loss of benefits; the source of financing of the plan and the identity of any organization through which benefits are provided; the date of the end of the plan year and whether the records of the plan are kept on a calendar, policy, or fiscal year basis; the procedures to be followed in presenting claims for benefits under the plan and the remedies available under the plan for the redress of claims which are denied in whole or in part (including procedures required under section 1133 of this title).

Section 3004 of the Employment Retirement Income Security Act of 1974 (29 U.S.C. § 1204) provides:

(a) Whenever in this Act or in any provision of law amended by this Act the Secretary of the Treasury and the Secretary of Labor are required to carry out provisions relating to the same subject matter (as determined by them) they shall consult with each other and shall develop rules, regulations, practices, and forms which, to the extent appropriate for

the efficient administration of such provisions, are designed to reduce duplication of effort, duplication of reporting, conflicting or overlapping requirements, and the burden of compliance with such provisions by plan administrators, employers, and participants and beneficiaries.

(b) In order to avoid unnecessary expense and duplication of functions among Government agencies the Secretary of the Treasury and the Secretary of Labor may make such arrangements or agreements for cooperation or mutual assistance in the performance of their functions under this Act, and the functions of any such agency as they find to be practicable and consistent with law. The Secretary of the Treasury and the Secretary of Labor may utilize, on a reimbursable or other basis, the facilities or services, of any department, agency, or establishment of the United States or of any State or political subdivision of a State, including the services, of any of its employees, with the lawful consent of such department, agency, or establishment; and each department, agency, or establishment of the United States is authorized and directed to cooperate with the Secretary of the Treasury and the Secretary of Labor and, to the extent permitted by law, to provide such information and facilities as they may request for their assistance in the performance of their functions under this Act. The Attorney General or his representative shall receive from the Secretary of the Treasury and the Secretary of Labor for appropriate action such evidence developed in the performance of their functions under this Act as may be found to warrant consideration for criminal prosecution under the provisions of this subchapter or other Federal law.